

OFFERING MEMORANDUM

BOOK-ENTRY ONLY

Commercial Paper Ratings:

Moody's: P- 1

S&P: A-1+

See "COMMERCIAL PAPER RATINGS" herein

\$300,000,000

State of California

Department of Water Resources

Water Revenue Commercial Paper Notes

Series 1

The commercial paper notes offered hereby are part of an issue of Water Revenue Commercial Paper Notes, Series 1 (the "Series 1 Notes") of the Department of Water Resources of the State of California (the "Department") which may be issued from time to time pursuant to the Resolution (defined below). The Series 1 Notes are issued as interest-bearing obligations, in book-entry form, registered in the name of Cede & Co., as nominee of The Depository Trust Company, New York, New York ("DTC"), in denominations of \$100,000 and integral multiples of \$1,000 in excess thereof. Purchasers of the Series 1 Notes will not receive physical certificates representing their beneficial interests in the Series 1 Notes.

The Series 1 Notes are limited, special obligations of the Department. The Series 1 Notes do not constitute a debt, liability, or obligation of the State of California. Neither the faith and credit nor the taxing power of the State of California is pledged to the payment of the principal of, or interest on, the Series 1 Notes.

The Series 1 Notes are not subject to redemption prior to maturity. The Department has appointed Goldman Sachs & Co. LLC, J.P. Morgan Securities LLC, and RBC Capital Markets, LLC as dealers for the Series 1 Notes.

Pursuant to a Revolving Credit Agreement, dated as of May 1, 2017 (as amended from time to time in accordance with its terms, the "Credit Agreement"), between the Department and Bank of America, N.A., (the "Bank"), the Bank has agreed to make loans to the Department, if necessary and subject to certain conditions precedent, to provide sufficient moneys for the full payment of the principal of and interest on the Series 1 Notes at the stated maturity of each Series 1 Note. *The Credit Agreement is a liquidity facility and under certain circumstances, the obligation of the Bank to make loans pursuant to the Credit Agreement will immediately terminate or be suspended and the Bank may suspend the ability of the Department to issue Series 1 Notes, and, in each case, such termination and/or suspension may occur without notice or payment to owners of the Series 1 Notes.* See "THE SERIES 1 NOTES – Security for the Series 1 Notes" and THE CREDIT AGREEMENT – Events of Default" and "– Remedies" herein.

In the opinion of Orrick Herrington & Sutcliffe LLP, Note Counsel to the Department, based on an analysis of existing laws, regulations, rulings and court decisions, and assuming, among other matters, the accuracy of certain representations and compliance with certain covenants, interest on the Series 1 Notes, when the Series 1 Notes are issued in accordance with the Resolution and the Tax Certificate, will be excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986 and is exempt from State of California personal income taxes. Note Counsel is of the further opinion that interest on the Series 1 Notes is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although Note Counsel observes that interest on the Series 1 Notes is included in adjusted current earnings when calculating corporate alternate minimum taxable income. A complete copy of the proposed form of opinion of Note Counsel is set forth in APPENDIX B – "PROPOSED FORM OF OPINION OF NOTE COUNSEL." Note Counsel expresses no opinion regarding any other tax consequences related to the ownership or disposition of or the amount, accrual or receipt of interest on, the Series 1 Notes. Note Counsel does not intend to take any action to update such opinion after the date of its delivery to the Department (expected to be May 4, 2017) or to determine if interest on the Series 1 Notes is thereafter excluded from gross income for federal income tax purposes. See "TAX MATTERS" herein.

May 2, 2017

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**STATE OF CALIFORNIA
DEPARTMENT OF WATER RESOURCES
OFFERING MEMORANDUM**

**Relating to its
\$300,000,000
Water Revenue Commercial Paper Notes
Series 1**

INTRODUCTION

The description and summaries of various documents in this Offering Memorandum do not purport to be comprehensive or definitive, and are qualified in their entirety by reference to each document for the complete details of all terms and provisions thereof. This Offering Memorandum also contains certain information with respect to the State Water Project and the contracts for a supply of water from the State Water Project (the “Water Supply Contracts”) between the Department on behalf of the State of California and 29 California public agencies (the “Contractors”).

INFORMATION CONCERNING THE OFFERING

Goldman, Sachs & Co. LLC, J.P. Morgan Securities LLC and RBC Capital Markets, LLC (collectively, the “Dealers”) have been appointed to serve as non-exclusive dealers for the Water Revenue Commercial Paper Notes Series 1 (the “Series 1 Notes”) of the State of California Department of Water Resources (the “Department”). This Offering Memorandum has been prepared by the Department. Each Dealer has reviewed the information in this Offering Memorandum in accordance with, and as part of, its responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Dealers do not guarantee the accuracy or completeness of such information. The information and expressions of opinion in this Offering Memorandum are subject to change without notice after the date on the cover page of this Offering Memorandum, and future use of this Offering Memorandum shall not otherwise create any implication that there has been no change in the matters referred to in this Offering Memorandum since the date on the cover page of this Offering Memorandum.

This Offering Memorandum is not to be construed as a contract between the Department or any Dealer and the purchasers of the Series 1 Notes.

THE SERIES 1 NOTES

General

The Series 1 Notes are being issued pursuant to the provisions of the Central Valley Project Act, Part 3 (commencing with Section 11100) of Division 6 of the California Water Code (the “CVP Act”) and the Water Revenue Commercial Paper Notes, Series 1 Resolution (No. DWR-CP-1), adopted as of March 1, 1993, as amended by the First Supplemental Resolution (No. DWR-CP-2), adopted as of May 1, 1996, the Second Supplemental Resolution (No. DWR-CP-3), adopted as of December 1, 1998, the Third Supplemental Resolution (No. DWR-CP-4), adopted as of July 1, 2004 and the Fourth Supplemental Resolution (No. DWR-CP-5), adopted as of May 1, 2017 (collectively, the “Resolution”). All capitalized terms used in this Offering Memorandum and not defined herein have the same meanings as in the Resolution.

This Offering Memorandum relates to the offering, from time to time, of up to \$300,000,000 aggregate principal amount of the Series 1 Notes authorized under the Resolution. The aggregate principal amount of the Series 1 Notes outstanding may be increased or decreased from time to time as provided in the Resolution. Over the last ten years the Department has issued and repaid more than \$4,368,424,000 aggregate principal amount of

commercial paper notes, which amount includes commercial paper notes issued to repay maturing commercial paper notes.

The Series 1 Notes will be issued in book-entry form, registered in the name of Cede & Co., as nominee of The Depository Trust Company, New York, New York (“DTC”), in denominations of \$100,000 and integral multiples of \$1,000 in excess thereof. DTC will act as securities depository for the Series 1 Notes and beneficial interests in the Series 1 Notes may be purchased in book entry form only. Purchasers of the Series 1 Notes will not receive physical certificates representing their beneficial interests in the Series 1 Notes. Principal of and interest payments on the Series 1 Notes are to be made to Cede & Co., as nominee of DTC, by wire transfer of same day funds by U.S. Bank National Association (formerly U.S. Bank Trust National Association) in its capacity as issuing and paying agent (the “Issuing and Paying Agent”) under the Issuing and Paying Agent Agreement, dated as of May 1, 2017 (the “Issuing and Paying Agent Agreement”), between the Department and the Issuing and Paying Agent. DTC’s current practice is to credit Direct Participant’s accounts on a payment date in accordance with their respective holdings shown on DTC’s records. See “DTC and Book-Entry” below.

Each Series 1 Note will mature in not more than 270 days from its date of issue, provided, however, so long as the Credit Agreement (hereinafter defined) is in effect, no Series 1 Note may be issued with a maturity date later than five days prior to May 1, 2020 (as such date may be extended pursuant to the Credit Agreement). The Series 1 Notes will be available for authentication and issuance, and will be payable at the offices of the Issuing and Paying Agent, New York, New York, or at the offices of its successor, as Issuing and Paying Agent. Series 1 Notes presented for payment to the Issuing and Paying Agent no later than 11:00 a.m. (New York City time) on a Business Day will be paid in immediately available funds on such Business Day. Series 1 Notes presented for payment to the Issuing and Paying Agent after 11:00 a.m. (New York City time) on a Business Day will be paid in immediately available funds on the next succeeding Business Day, without accrual of additional interest.

Each Series 1 Note will be dated the date of its authentication and will bear interest from its date of authentication; payable on its maturity date, at an annual rate computed on the basis of actual days elapsed on a 365-day or 366-day year, whichever is applicable.

The Series 1 Notes will be issued, sold and delivered in denominations of \$100,000 and integral multiples of \$1,000 in excess thereof. The purchase price for the Series 1 Notes is to be paid, and amounts payable by the Department with respect to the Series 1 Notes will be paid, in immediately available funds.

The Series 1 Notes are not subject to redemption prior to maturity.

Series 2 Notes

In addition to the Series 1 Notes, the Department plans to authorize as of May 3, 2017, the issuance of its Water Revenue Commercial Paper Notes Series 2 (the “Series 2 Notes”), in an aggregate principal amount of \$500,000,000. The Series 2 Notes will be issued pursuant to the provisions of the CVP Act and the Water Revenue Commercial Paper Notes, Series 2 Resolution (No. DWR-CP-1), adopted as of May 1, 2017. The Series 2 Notes constitute Parity Debt. See “THE SERIES 1 NOTES – Security for the Series 1 Notes – *Sources of Revenues.*”

Purpose of the Series 1 Notes

Proceeds of the Series 1 Notes will be used to (1) provide funds for the construction costs of certain Water System Projects (see “WATER SYSTEM PROJECTS” herein), (2) reimburse the Department for funds expended for the construction costs of certain Water System Projects, (3) fund interest on Series 1 Notes until the Department issues its Central Valley Project Water System Revenue Bonds (the “Water System Revenue Bonds”), the proceeds of which will be used to repay the Series 1 Notes, and (4) pay costs of issuance of the Series 1 Notes. While the Department expects to use the proceeds of Series 1 Notes for construction costs related

to Water System Projects other than the Oroville Dam Spillway Recovery and Restoration Project, which costs are expected to be financed with Series 2 Notes, the Department may, in its sole discretion, also use proceeds of the Series 1 Notes for construction costs of the Oroville Dam Spillway Recovery and Restoration Project. See ““WATER SYSTEM PROJECTS – Oroville Dam Spillway Recovery and Restoration Project.”

DTC and Book-Entry

The information in this section concerning DTC and DTC’s book-entry system has been obtained from sources that the Department and the Treasurer of the State of California (the “Treasurer”) believe to be reliable, but the Department and the Treasurer take no responsibility for the accuracy thereof.

DTC will act as securities depository for the Series 1 Notes. The Series 1 Notes will be issued as fully-registered securities registered in the name of Cede & Co. (DTC’s partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered Series 1 Note certificate has been issued for the aggregate principal amount of the Series 1 Notes and has been deposited with DTC.

DTC is a limited-purpose trust company organized under the New York Banking Law, a “banking organization” within the meaning of the New York Banking Law, a member of the Federal Reserve System, a “clearing corporation” within the meaning of the New York Uniform Commercial Code, and a “clearing agency” registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 3.5 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments (from over 100 countries) that DTC’s participants (“Direct Participants”) deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants’ accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation (“DTCC”). DTCC is the holding company for DTC, National Securities Clearing Corporation and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly (“Indirect Participants”). DTC has a Standard & Poor’s rating of AA+. The DTC Rules applicable to its Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com.

Purchases of Series 1 Notes under the DTC system must be made by or through Direct Participants, which will receive a credit for the Series 1 Notes on DTC’s records. The ownership interest of each actual purchaser of each Series 1 Note (“Beneficial Owner”) is in turn to be recorded on the Direct and Indirect Participants’ records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Series 1 Notes are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in Series 1 Notes, except in the event that use of the book-entry system for the Series 1 Notes is discontinued.

To facilitate subsequent transfers, all Series 1 Notes deposited by Direct Participants with DTC are registered in the name of DTC’s partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of Series 1 Notes with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Series 1 Notes; DTC’s records reflect only the identity of the

Direct Participants to whose accounts such Series 1 Notes are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of Series 1 Notes may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Series 1 Notes, such as defaults, and proposed amendments to the Series 1 Note documents. For example, Beneficial Owners of Series 1 Notes may wish to ascertain that the nominee holding the Series 1 Notes for their benefit has agreed to obtain and transmit notices to Beneficial Owners.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to Series 1 Notes unless authorized by a Direct Participant in accordance with DTC's MMI Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the Department as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Series 1 Notes are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Principal and interest payments on the Series 1 Notes will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the Department or the Issuing and Paying Agent, as applicable, on payable dates in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC, the Department or the Issuing and Paying Agent, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal and interest to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Department or the Issuing and Paying Agent, as applicable, disbursement of such payments to Direct Participants shall be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners shall be the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as securities depository with respect to the Series 1 Notes at any time by giving reasonable notice to the Department or the Issuing and Paying Agent. Under such circumstances, in the event that a successor depository is not obtained, Series 1 Note certificates are required to be printed and delivered.

The Department may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). In that event, Series 1 Note certificates will be printed and delivered.

The foregoing description of the procedures and record keeping with respect to beneficial ownership interests in the Series 1 Notes, payment of principal of and interest with respect to the Series 1 Notes to Direct Participants, Indirect Participants or Beneficial Owners, confirmation and transfer of beneficial ownership interest in such Series 1 Notes and other related transactions by and between DTC, the Direct Participants, the Indirect Participants and the Beneficial Owners is based solely on information provided by DTC. Accordingly, no representations can be made concerning these matters and neither the Direct Participants, the Indirect Participants nor the Beneficial Owners should rely on the foregoing information with respect to such matters but should instead confirm the same with DTC or the Participants, as the case may be.

THE ISSUING AND PAYING AGENT, AS LONG AS A BOOK-ENTRY ONLY SYSTEM IS USED FOR THE SERIES 1 NOTES, WILL SEND ANY NOTICE TO OWNERS ONLY TO DTC. ANY FAILURE

OF DTC TO ADVISE ANY PARTICIPANT, OR OF ANY PARTICIPANT TO NOTIFY ANY BENEFICIAL OWNER, OF ANY NOTICE AND ITS CONTENT OR EFFECT WILL NOT AFFECT THE VALIDITY OR SUFFICIENCY OF THE ACTION PREMISED ON SUCH NOTICE.

The Department and the Treasurer cannot and do not give any assurances that DTC will distribute to Participants, or that Participants or others will distribute to the Beneficial Owners, payments of principal of and interest and premium, if any, on the Series 1 Notes paid or other notices or that they will do so on a timely basis or will serve and act in the manner described in this Offering Memorandum. Neither the Department nor the Treasurer is responsible or liable for the failure of DTC or any Direct Participant or Indirect Participant to make any payments or give any notice to a Beneficial Owner with respect to the Series 1 Notes or any error or delay relating thereto.

SO LONG AS CEDE & CO. IS THE REGISTERED OWNER OF THE SERIES 1 NOTES, AS NOMINEE OF DTC, REFERENCES HEREIN TO THE HOLDERS SHALL MEAN CEDE & CO., AS AFORESAID, AND SHALL NOT MEAN THE BENEFICIAL OWNERS OF THE SERIES 1 NOTES.

Security for the Series 1 Notes

Sources of Revenues. Except as described below under “CALIFORNIA STATE WATER PROJECT – Storage Facilities,” the Department expects to repay principal of and interest on its Series 1 Notes with the proceeds of additional Series 1 Notes until the Department issues Water System Revenue Bonds to provide permanent financing for those Water System Projects financed with the Series 1 Notes.

In the event the Department does not issue additional Series 1 Notes or Water System Revenue Bonds to repay maturing Series 1 Notes, the Series 1 Notes may, subject to certain terms and conditions, be repaid with funds loaned to the Department by Bank of America, N.A. (the “Bank”), pursuant to a revolving line of credit (the “line of credit”) extended under the terms of the Credit Agreement. Under the Resolution, the Department may substitute the line of credit (or any other liquidity facility then in effect) with an alternate liquidity facility, provided that any Series 1 Notes that were outstanding on the day immediately preceding the effective date of such substitution either mature on such substitution date or, if they will remain outstanding after such substitution date, the Holders of such Series 1 Notes were notified of the possibility of such substitution prior to the issuance of such Series 1 Notes. The Treasurer will give the registered owners of the Series 1 Notes notice of any such substitution not later than 30 days after the occurrence thereof.

Under the Water Supply Contracts, the Contractors are required to pay to the Department amounts calculated to return to the Department its costs of the State Water Project allocated to water and power supply. See “THE WATER SUPPLY CONTRACTS” herein. The revenues pledged to the Series 1 Notes (the “Revenues”) are that portion of payments under the Water Supply Contracts attributable to the Water System Projects, to the extent financed by the Series 1 Notes. Said pledge ranks on a parity with the pledge of Revenues under the Credit Agreement to secure the obligations of the Department to the Bank thereunder, including, without limitation, the obligation of the pay any loans made by the Bank to pay Series 1 Notes, together with all accrued interest thereon.

Notwithstanding anything in the Resolution to the contrary, in the event that moneys received by the Department under the Water Supply Contracts are insufficient to pay all amounts due under all Senior Lien Obligations, the Series 1 Notes and all Parity Debt, such moneys shall be allocated first to the payment of amounts due under all such Senior Lien Obligations, then to the payment of amounts payable on the Series 1 Notes and any Parity Debt, on a pro rata basis. The Owners of the Series 1 Notes shall have an equal priority right with the holders of Parity Debt to moneys received by the Department under the Water Supply Contracts.

The term “Senior Lien Obligations” is defined in the Resolution to mean the Water System Revenue Bonds and other obligations having an equal or senior priority right with the Water System Revenue Bonds to moneys received by the Department under the Water Supply Contracts, including, without limitation, the Department's payment obligations with respect to its Central Valley Project Power Facilities Revenue Bonds (currently consisting of the Department's Devil Canyon-Castaic Bonds) and the Department's obligation to deposit money in the California Water Resources Development Bond Fund.

The term “Parity Debt” is defined in the Resolution to mean amounts owing under the Credit Agreement and any indebtedness, installment sale obligation, lease obligation or other obligation of the Department for borrowed money or interest rate swap agreement having an equal priority right to moneys received by the Department under the Water Supply Contracts and therefore payable on a parity with the Series 1 Notes (whether or not any Series 1 Notes are Outstanding). The Resolution provides that the Owners of the Series 1 Notes shall have an equal priority right with the holders of Parity Debt to moneys received by the Department under the Water Supply Contracts.

Allocation of State Water Project Revenues. Under the California Water Code, State Water Project revenues are allocated between two funds, depending on the source of the revenues.

State Water Project revenues from Water System Projects financed by Water System Revenue Bonds are, to the extent allocated to the Water System Revenue Bonds, deposited in the Central Valley Project Revenue Fund and pledged to the repayment of Water System Revenue Bonds. State Water Project revenues from the Devil Canyon Castaic Facility are deposited in the Central Valley Project Revenue Fund and pledged to the payment of the Devil Canyon Castaic Bonds. State Water Project revenues from the Water System Projects financed by Series 1 Notes are, to the extent allocated to the Series 1 Notes, deposited in the Central Valley Project Revenue Fund and pledged to the payment of the Series 1 Notes.

All other State Water Project revenues are deposited in the California Water Resources Development Bond Fund and used first to pay the reasonable operating and maintenance costs of the State Water Resources Development System (which includes the State Water Project); second, to reimburse the General Fund of the State for the payment of the general obligation bonds issued to finance a portion of the capital costs of the State Water Project; and thereafter to the payment of the costs of the acquisition and construction of the State Water Resources Development System.

Outstanding Obligations. The Department has issued forty-nine series of Water System Revenue Bonds in an aggregate principal amount of \$9,426,025,000, of which \$2,640,715,000 in aggregate principal amount were outstanding as of March 1, 2017. The Department has also issued \$1,526,155,000 in aggregate principal amount of revenue bonds to finance certain power facilities of the State Water Project, of which \$45,475,000 in aggregate principal amount were outstanding as of April 1, 2017 (the Department's Devil Canyon-Castaic Bonds). Such revenue bonds are secured by revenues of the Department other than those that are pledged to secure the Series 1 Notes and were and are issued under and secured by resolutions separate and apart from the Resolution authorizing and securing the Series 1 Notes.

The Department may issue additional Water System Revenue Bonds on a parity basis with outstanding Water System Revenue Bonds to finance the costs allocated to any Water System Project, including the cost of planning, construction or acquisition, or to refund Water System Revenue Bonds if, among other things, the Department certifies that (a) after the issuance of such Water System Revenue Bonds, estimated Revenues in each year will not be less than the sum of (i) 1.25 times debt service to be paid from Revenues, plus (ii) estimated Water System Operating Expenses, (b) the Debt Service Reserve Account established pursuant to the Central Valley Project Water System Revenue Bonds, General Bond Resolution, No. DWR-WS-1 of the State of California Department of Water Resources, adopted as of July 1, 1986 (as supplemented from time to time, the “Water System Revenue Bonds Resolution”) is projected to contain on the first interest payment date on which

interest for such additional Water System Revenue Bonds is payable from Revenues, an amount equal to the Reserve Account Requirement, and (c) the Treasurer must have received evidence that the issuance of the additional Water System Revenue Bonds will not result in the lowering of any rating then assigned to any then outstanding Water System Revenue Bonds by any nationally recognized rating agency. All capitalized terms used in this paragraph have the same meanings as in the Water System Revenue Bond Resolution.

Pursuant to Section 11731 and 11751 of the CVP Act, the Department may issue revenue bonds bearing interest at a rate not exceeding 12 percent per annum and may sell revenue bonds at a price of not less than 94 percent. If the Department determines that interest on revenue bonds will be subject to federal income taxation and to the extent permitted by applicable law, such bonds may bear interest at such rate or rates, and may be sold at such price or prices, as the Department may determine.

In addition to the revenue bond obligations described above, a large portion of the State Water Project has been financed from the issuance of \$1,582,400,000 in aggregate principal amount of State general obligation bonds, of which \$96,500,000 in aggregate principal amount were outstanding as of April 1, 2017.

Pledge of Revenues. The Series 1 Notes are limited, special obligations of the Department and are payable as to both principal and interest exclusively from the Revenues and other amounts pledged in the Resolution. The proceeds of all obligations issued by the Department to repay the Series 1 Notes, all Revenues, all amounts (including proceeds of the Series 1 Notes) held by the Treasurer pursuant to the terms of the Resolution (except for amounts held in the Rebate Fund) and all amounts held by the Issuing and Paying Agent under the Resolution and under the Issuing and Paying Agent Agreement are pledged to secure the payment of the principal of and interest on the Series 1 Notes in accordance with their terms, subject only to the provisions of the Resolution permitting the application thereof for the purposes and on the terms and conditions set forth therein. Said pledge shall constitute a lien on the Revenues and amounts in such funds and shall be valid and binding from and after delivery by the Issuing and Paying Agent of the Series 1 Notes, without any physical delivery of such Revenues and amounts or further act.

THE SERIES 1 NOTES ARE LIMITED, SPECIAL OBLIGATIONS OF THE DEPARTMENT OF WATER RESOURCES. THE SERIES 1 NOTES DO NOT CONSTITUTE A DEBT, LIABILITY, OR OBLIGATION OF THE STATE OF CALIFORNIA. NEITHER THE FAITH AND CREDIT NOR THE TAXING POWER OF THE STATE OF CALIFORNIA IS PLEDGED TO THE PAYMENT OF THE PRINCIPAL OF, OR INTEREST ON THE SERIES 1 NOTES.

THE DEPARTMENT

Introduction

The Department is a department within the California Natural Resources Agency of the State of California (the "State") and is responsible for the planning, construction, operation and maintenance of the State Water Project. The Department is also responsible for, among other things, the operation of programs for the safety of dams, flood management, local assistance and subventions and other water-related matters. The Department was established in 1956 by an act of the State Legislature that combined the functions of the Water Project Authority and certain responsibilities of the Department of Public Works' former Division of Water Resources. As of April 1, 2017, the Department employs approximately 3,326 full-time staff throughout the State.

Fund Accounting

The Department's operations with respect to the State Water Project are accounted for and conducted under special funds established by the California Water Code, principally the State Water Resources Development Bond Fund, the Central Valley Project Construction Fund and the Central Valley Project Revenue Fund. The

Department's operations with respect to the State Water Project are separate and apart from the Department's operations that are funded by State General Fund appropriations and from charges collected from customers of certain of the State's investor owned utilities related to the Department's Power Supply Revenue Bonds.

Investment of Department Moneys

The Department uses the State's Centralized Treasury System. Moneys on deposit in the State's Centralized Treasury System are invested by the Treasurer in the Pooled Money Investment Account (the "PMIA"). The State's treasury operations are managed in compliance with the California Government Code and according to a statement of investment policy that sets forth permitted investment vehicles, liquidity parameters and maximum maturity of investments. The PMIA operates with the oversight of the Pooled Money Investment Board (consisting of the Treasurer, the State Controller and the Director of Finance). The PMIA is not now invested, nor has it ever been invested, in structured investment vehicles or collateralized debt obligations. The PMIA Portfolio performance and the PMIA's holdings are displayed quarterly on the Treasurer's website and may be accessed under PMIB Quarterly Reports. The PMIA is not currently invested in auction rate securities. The Treasurer does not invest in leveraged products or inverse floating rate securities. The investment policy permits the use of reverse repurchase agreements subject to limits of no more than 10 percent of the total amount in the PMIA. All reverse repurchase agreements are cash matched either to the maturity of the reinvestment or an adequately positive cash management date which is approximate to the maturity of the reinvestment.

Department moneys held in the PMIA generally consist of Contractor payments to the Department. Department moneys held in the PMIA are invested on a short-term basis until they are expended for their designated purpose, replacement reserves, construction funds and debt service reserves.

CALIFORNIA STATE WATER PROJECT

Introduction

The State Water Project is one of the largest water supply projects undertaken in the history of water development and encompasses a complex of dams, reservoirs, pumping facilities, powerplants, aqueducts and pipelines owned and operated by the State. The Department is responsible for the planning, construction, operation and maintenance of the State Water Project. After a construction program that commenced in 1957, the project is now providing water to all 29 Contractors. The maximum, contracted amount of State Water Project water each Contractor may request for delivery each year is set forth in "Table A" of the related Water Supply Contract. Under the Water Supply Contracts presently in effect, the Contractors may request Table A water from the State Water Project in a maximum amount of 4,172,686 acre-feet. See "THE WATER SUPPLY CONTRACTS" herein. An acre-foot is the amount of water that will cover one acre of land to a depth of one foot, and is equivalent to 325,900 gallons. However, the amount of water that may be made available for delivery by the State Water Project in any year will depend on various factors, and the Water Supply Contracts provide for reductions in Table A water deliveries if the total amount available for delivery is insufficient to satisfy all Contractor requests. See "STATE WATER PROJECT WATER SUPPLY" herein.

More than two-thirds of California's natural water supply originates in the northern third of the State, but more than three-quarters of the demand for water is in the southern two-thirds, which includes the San Francisco Bay area, the San Joaquin Valley, the central California coast and Southern California. The State Water Project was developed in order to deliver water to areas of need throughout the State for domestic, industrial and agricultural purposes, as well as to provide flood control, recreation, fish and wildlife enhancement, hydroelectric power and other benefits.

The State Water Project includes aqueducts, dams and reservoirs, pipelines, pumping facilities, hydroelectric generating facilities and other power plants. The State Water Project does not include any water treatment facilities or any desalination or other facilities for the production of water.

Portions of the State Water Project system consist of facilities developed and used jointly with the federal Central Valley Project operated by the U.S. Bureau of Reclamation (the “Bureau”). In addition, both projects have primary sources of water north of the delta formed by the confluence of the Sacramento and San Joaquin Rivers (the “Delta”), transport water across the Delta, and draw water from the southern edge of the Delta. The federal Central Valley Project, like the State Water Project, provides water for irrigation in the Central Valley, urban water supply, water quality, flood control, power, recreation, and fish and wildlife enhancement. Costs for the jointly developed facilities are shared, with approximately 55 percent being paid by the State and 45 percent being paid by the federal government. In 1986, the Department and the Bureau entered into a Coordinated Operation Agreement (the “COA”) under which the State Water Project and the federal Central Valley Project coordinate operations, including releases from upstream reservoirs and pumping from the Delta. The COA permits increased operational efficiency for both projects, ensures that each project receives an equitable share of available surplus water, and provides for sharing responsibilities in meeting certain Delta water quality standards.

Aqueduct System; Pumping Facilities

All 647 miles of the initially planned aqueduct system have been completed. With the addition of the Grizzly Valley pipeline, the Thermalito Powerplant power canal and tail channel, and the extension of the East Branch aqueduct, the entire aqueduct system totals 705 miles. The main stem of the aqueduct system, the California Aqueduct, is 443 miles in length and transports water from the Delta through the Central Valley of California, over the Tehachapi Mountains and then into Southern California. Major branch aqueducts include the 28-mile North Bay Aqueduct north of the San Francisco Bay, the 45-mile South Bay Aqueduct in the southern San Francisco Bay area, the 116-mile Coastal Branch aqueduct from the southern San Joaquin Valley over the coastal mountains to the central California coast north of Los Angeles, the 32-mile West Branch aqueduct in Southern California and the 33-mile extension of the East Branch aqueduct in Southern California. Aqueducts consist primarily of open concrete lined canals, siphons and underground pipelines. The main stem of the California Aqueduct has 381 miles of canals and siphons, 49 miles of pipelines or tunnels and 13 miles of channels and reservoirs. The branch aqueducts are mostly pipelines and tunnels rather than canals.

State Water Project facilities also include 20 pumping plants and stations, four pumping-generating plants, and five hydroelectric powerplants.

Storage Facilities

State Water Project facilities include 34 storage facilities of which 21 are primary reservoirs and lakes. Reservoirs are used to provide long-term water storage, manage water flows, provide recreation, and generate power.

As of May 4, 2017, proceeds of the Series 1 Notes are not expected to be applied to the recovery and restoration of the Oroville Dam spillways. See Oroville Dam Spillway Recovery and Restoration Project below. Any Series 1 Notes applied to such costs prior to May 4, 2017, are expected to be paid with the proceeds of Series 2 Notes. Series 2 Notes are expected to be issued to provide for such costs on and after May 4, 2017.

The Department’s Division of Safety of Dams routinely inspects operating dams and may impose operating restrictions on dams and reservoirs that could adversely affect the operation of the State Water Project. One State Water Project dam, Perris Dam, is subject to a Division of Safety of Dams order.

Oroville Dam Spillway Recovery and Restoration Project

In February of 2017 after a significant amount of rainfall, the Department determined that a large slab of concrete was missing from the control spillway of the Oroville Dam, the tallest dam in the United States that serves mainly water supply, hydroelectricity generation and flood control. The Department immediately reduced the outflows in order to assess the damage to the control spillway.

As a result of reduced releases from the damaged control spillway and continued rainfall and increased snow melt runoff, the inflows to Lake Oroville exceeded the outflows requiring the use of the emergency spillway for the first time in Oroville Dam's 49 year history. Within a short period, signs of erosion below the emergency spillway were detected, causing the Department to once again increase the outflows from the damaged control spillway in order to prevent a potential failure of the emergency spillway.

During this same timeframe and with a concern regarding the potential of failure of the emergency spillway, the Butte County Sheriff on February 12, 2017 issued an evacuation order for Oroville and surrounding communities. That order was lifted on February 14, 2017. Other areas adjacent to the Feather River in counties south of Butte County were also temporarily evacuated. Concurrently, the increase in outflows through the control spillway dropped the lake down to a level where the emergency spillway was no longer in use. While addressing the Oroville spillway emergency, the Department consulted and coordinated with federal, State and local agencies, including FERC, the Department's Division of Safety of Dams, the Federal Emergency Management Administration, the California Office of Emergency Services and Butte County.

In response to the massive amounts of rainfall and flooding that were occurring throughout parts of California in early 2017, the Governor issued four Proclamations of a State of Emergency between January 23, 2017 and March 7, 2017 addressing areas of flooding and potential flooding, including at Oroville Dam. Among other things, the Governor directed that actions be taken to mitigate the effects of the flooding and to reduce the risk of additional flooding. On April 1, 2017, the President issued a Federal Major Disaster Declaration for areas in California affected by the severe storms and flooding, which will provide for, among other things, a federal contribution to the costs of the Department's emergency response activities and repair and replacement work at Oroville.

While the Oroville Dam itself has not shown any signs of adverse effects from the spillway incident and remains structurally sound, costs associated with the current recovery and restoration efforts at Oroville Dam are expected to be substantial. Those recovery and restoration efforts will be undertaken in two phases. Phase 1 is the response phase that includes the emergency protective measures and debris removal that is on-going. Phase 2 is the recovery and restoration phase that includes restoring the control and emergency spillways to a condition capable of operating through the next flood season by November 1, 2017. The costs of each phase are still being determined, a substantial portion of which are expected to be reimbursed by the Federal Government. Any of such costs not reimbursed by the Federal Government and allocable to water transportation and conservation costs payable under the Water Supply Contracts are expected to be financed long-term with Water System Revenue Bonds. The amount so financed could be significant. However, the Department does not believe the costs arising from this project will materially impact the Department's operations or ability to pay debt service on the Water System Revenue Bonds or the Series 1 Notes.

The Oroville Dam Spillway Recovery and Restoration Project consists of emergency protective measures and debris removal, restoring the control and emergency spillways of the Oroville Dam to an operational level consistent with prudent water level management, and other related improvements, additions, and repairs to equipment and appurtenant features and facilities.

Operational Control

The Department schedules and controls the operation of the State Water Project from a central operations center. This central operations center uses the communication and Supervisory Control and Data Acquisition (“SCADA”) systems to monitor and control the water and power movements in the aqueducts, pipelines and tunnels of the State Water Project in addition to the 29 pumping and generating plants of the State Water Project. Both the SCADA and communication systems are currently being upgraded and such upgrading is expected to be completed in 2018. When the upgrades are complete the central operations center will continue to monitor and remotely control all State Water Project facilities. Effective remote operations include start-up and shut down of pumping and generating units and opening or closing of gates and valves which control the flow of water throughout the State Water Project in a coordinated manner. Under emergency or back-up operation mode, the operations of each field division are handled at the local field division level.

Seismic Considerations

State Water Project facilities were designed to withstand earthquakes without incurring major damage, in accordance with the Department’s Division of Safety of Dams criteria in effect at the time of their construction. Dams, for example, were designed to accommodate movement under and within their foundations and to resist earthquake forces on their embankments. Earthquake loads were taken into consideration in the design of project facilities such as pumping plants and power plants. Should further scientific and/or engineering research indicate that as-built seismic loads may be exceeded in future earthquakes, these criteria will need to be re-evaluated, and affected State Water Project facilities may need to be strengthened accordingly.

Major portions of the California Aqueduct are located parallel to and near the San Andreas Fault and other active faults. Faults known to be seismically active are crossed either by canal at ground level or by pipeline at very shallow depths, to ease repair in case of damage from movement along a fault. The location of check structures on the canal allows for hydraulic isolation of any needed fault-crossing repairs.

Since the Loma Prieta earthquake of October 1989, 13 earthquakes of magnitude 6.5 or greater have occurred either in, or within 100 miles of, California. Of those earthquakes, only the January 1994 Northridge earthquake occurred close enough to the State Water Project to cause damage to State Water Project facilities, however, the damage caused was minor. The recent Napa earthquake of August 2014 had a 6.0 magnitude and did not cause damage to State Water Project facilities. Large earthquakes will continue to occur in and near California for the foreseeable future. Their magnitude, location and time of occurrence cannot currently be predicted. Under the Water Supply Contracts, the Contractors are required to continue making all payments to the Department when due despite any interruption in water supply due to an earthquake.

A major seismic event causing damage to State Water Project facilities could disrupt the operation of the State Water Project or require significant unexpected capital expenditures. Such an event could also have an impact on Central Valley and Delta levees. See “STATE WATER PROJECT WATER SUPPLY – Central Valley and Delta Levees.”

Self-Insurance; Financing of Emergency Repairs

The State does not maintain commercial insurance for the State Water Project, nor does it maintain a funded insurance reserve. However, the Department maintains a replacement reserve, currently in the approximate amount of \$32.06 million, which it uses to replace certain equipment periodically. The Department is authorized to cause the issuance of notes, payable from available revenues or federal reimbursements under the National Disaster Act, for the purpose of providing funds for emergency repairs to power projects or the State Water Project necessitated by natural disasters, provided that certain conditions can be met.

Security Efforts; Emergency Preparedness

Department operations staff and security personnel undertake security efforts to safeguard the infrastructure, key facilities, information technology systems, public, personnel and the water supply of the State Water Project. Security measures include restrictions on public access to recreational and other State Water Project facilities, monitoring of State Water Project facilities, and a State Water Project-wide security plan.

The Department coordinates its emergency management and security efforts with the California Governor's Office of Emergency Services, other State departments, and various local, State and federal law enforcement agencies as a matter of routine security procedure, and coordinates with other water, health, environmental and public safety agencies as needed. In addition, the Department is a participant on various California Emergency Management Agency committees.

Although the Department has undertaken many emergency preparedness and security improvements, a terrorist attack or significant natural disaster could materially impair system operations and water deliveries.

Environmental Considerations

Projects undertaken by the Department are generally subject to the California Environmental Quality Act ("CEQA") and certain projects involving the participation of the Bureau or other federal agencies are also subject to the National Environmental Policy Act of 1969, as amended (42 U.S.C. Section 4321) ("NEPA").

Under CEQA, a project that may have a significant effect on the environment and is to be carried out or approved by a public agency must comply with a comprehensive environmental review process, including the preparation of an Environmental Impact Report ("EIR"). The EIR reflects not only an independent technical analysis of the project's potential impacts, but also the comments of other agencies with some form of jurisdiction over the project and the comments of interested members of the public. Contents of the EIR include a detailed statement of the project's significant environmental effects; any such effects that cannot be avoided if the project is implemented; mitigation measures proposed to minimize such effects; alternatives to the proposed project; the relationship between local and short-term uses and long-term productivity; any significant irreversible environmental changes that would result from the project; the project's growth-inducing impacts; and a brief statement setting forth the agency's reasons for determining that certain effects are not significant and hence do not require discussion in the EIR. Before approving a project the agency must make findings on whether or how it can mitigate the significant environmental effects of the project. If the agency requires mitigation, the agency must adopt a mitigation monitoring plan to determine whether the mitigation is carried out during project implementation. If the agency determines that the project itself will not have a significant effect on the environment, it may adopt a written statement (called a negative declaration) to that effect and need not prepare an EIR. After deciding to approve or carry out a project, either following the EIR process or after adopting a negative declaration, the agency must file notice of such determination. Any action or proceeding challenging the agency's determination must be brought within 30 days following the filing of such notice. Actions have been, and in the future may be, filed against the Department challenging the Department's compliance with CEQA, including the adequacy of the EIR or other environmental documents, for a particular project. If the action is successful, the particular project could be delayed, revised, suspended or canceled. CEQA also contains a number of exemptions, which the Department uses for its projects when appropriate.

As part of its regular planning and budgetary process, the Department gives careful attention to environmental considerations. All projects are evaluated under the Department's environmental impact review procedures, developed in compliance with federal and State laws and regulations.

STATE WATER PROJECT WATER SUPPLY

General

This section describes the historical water supply available for delivery by the State Water Project and certain factors that have had or may in the future have an effect on the availability of such water supply. The Department can give no assurances that future legislation or regulation in any of the areas discussed in this section will not affect State Water Project operations including, but not limited to, reductions in the water supply available to the State Water Project.

Annual Water Deliveries

The annual water supply available for delivery by the State Water Project will vary from year to year depending on many factors including hydrologic conditions. The Department's annual determination of the State Water Project's delivery capability is based on extensive and ongoing analyses of operational capability taking into account (i) storage levels at the beginning of the year, (ii) target storage levels at the end of the year, (iii) the actual amount of snow and rainfall that has occurred to date in the year and a conservative estimate of the amount of snow and rainfall that may occur over the remainder of the year, (iv) the operational capacity of State Water Project facilities, and (v) operational mandates for in-stream water requirements and environmental protection of the Delta as imposed by federal and state regulatory agencies. For each of the last ten years, each Contractor has requested 100 percent of their Annual Table A Amount for that year. See "THE WATER SUPPLY CONTRACTS – Basic Contract – Annual Table A Amount." If delivery capability was less than 100 percent of such requests, using the procedure described above the Department allocated Table A water to the Contractors as a percentage of Contractor requests. The following table provides the percentage of allocated Table A water, the Table A water delivered, and the total water delivered to the Contractors for the last ten years.

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**Annual Water Deliveries of the State Water Project
(Percentage of Contractor Requests)
(Acre-Feet in Thousands)**

Year	Allocated Table A Water⁽¹⁾	Table A Water Delivered to Contractors in Acre-Feet⁽²⁾	Total Water Delivered to Contractors in Acre-Feet⁽³⁾
2007	60%	2,181	3,284
2008	35	1,248	2,152
2009	40	1,485	2,222
2010	50	2,011	2,831
2011	80	2,848	3,662
2012	65	2,594	2,886
2013	35	1,620	2,213
2014	5	474	1,239
2015	20	852	1,499
2016	60	2,016	2,351

- (1) The allocation of annual Table A water for each calendar year is determined in the Spring of that year and based on hydrological conditions at the time of determination and other factors as described in the preceding paragraph. The Spring determination of annual water for a given calendar year is evaluated throughout the winter and may be revised in response to hydrologic conditions and regulatory mandates.
- (2) Historical deliveries reflect changes resulting from the reclassification of water to or from these water types; flexible withdrawal, Non-State Water Project local water rights, or Non-State Water Project water. Contractors also may choose to receive allocated Table A water in a later year subject to operational constraints (carryover). Water available as determined by the Department, on behalf of the State, not needed for fulfilling contractors' maximum annual Table A deliveries under the applicable Water Supply Contract or for meeting operational needs of the State Water Project, including water storage goals ("Article 21 water") is delivered along with Table A allocations.
- (3) All water delivered to Contractors, including but not limited to, Table A water for that year; Table A water allocated to a previous year (carryover); water surplus to operational needs, water quality, and Delta requirements; Article 21 water, transfer; purchased; and Non-State Water Project water.

The delivery of less than 100 percent of Contractor requests for Table A water in the ten years listed in the preceding table reflects the impact of one or more of the factors listed in the preceding paragraph affecting the Department's annual determination of the State Water Project's delivery capability in each such year.

According to the Final Appendices to the State Water Project Delivery Capability Report 2015, dated July 2015, the Department estimates that if annual precipitation conditions vary in the same manner as they have over the eighty-two year period of analysis (water years 1922-2003, a water year consists of twelve consecutive calendar months beginning with the month of October and is identified by the calendar year in which it ends), the State Water Project would be capable of delivering at least 1,910,000 acre-feet of water in approximately 75 percent of the water years, at least 2,650,000 acre-feet of water in approximately 50 percent of the water years, and at least 3,100,000 acre-feet of water in approximately 25 percent of the water years. Under the Water Supply Contracts presently in effect, the Contractors may request Table A water from the State Water Project in a maximum amount of 4,172,786 acre-feet. The maximum, contracted amount of Table A water each Contractor may request for delivery each year were established when the Water Supply Contracts were executed and delivered, prior to the final determination of the scope of the State Water Project.

State and Federal Regulations Affecting the State Water Project

The following subsections describe certain state and federal regulation of the State Water Project and related litigation that could impact the ability of the Department to deliver water to the Contractors. The respective obligations of the Contractors to make payments in amounts sufficient to pay debt service on the Series 1 Notes and the Water System Revenue Bonds are not conditioned on the amount of water delivered. See “THE SERIES 1 NOTES – Security for the Notes – *Source of Revenues*” and “THE WATER SUPPLY CONTRACTS” and the “STATE WATER PROJECT WATER SUPPLY – General” herein.

Bay-Delta Water Rights and Water Quality Regulation. The State Water Project diverts unregulated flow, and rediverts water it has stored upstream and later released into the Feather River, from the Delta. The Delta is also the source of water for local agricultural, municipal and industrial needs, and, in addition, supports significant resident and anadromous fish and wildlife resources and important recreational uses of water. Both the State Water Project’s upstream reservoir operations and its Delta diversions can at times affect these other uses of Delta water directly, or indirectly, through impacts on Delta water quality.

The SWRCB is responsible for regulating the State Water Project (along with the federal Central Valley Project operated by the Bureau) under the SWRCB’s water quality and water rights authorities to protect the reasonable needs of all beneficial uses of Delta waters. In this regard, in 1978, the SWRCB adopted a Water Quality Control Plan for the Bay-Delta estuary which has been amended periodically in 1995 and most recently in 2006. The Water Quality Control Plan for the Bay-Delta estuary as amended through 2006 is referred to herein as the “2006 Plan”. The SWRCB is currently in the process of updating the Water Quality Control Plan. In March 2000, the SWRCB implemented the Water Quality Control Plan, as amended through 1995, through a water rights decision known as “D 1641.” D 1641 is still in effect and requires the State Water Project and the federal Central Valley Project to meet the Water Quality Control Plan’s objectives for maintaining water quality. In addition, D 1641 recognizes a settlement (known as the “Sacramento Valley Water Management Program”) among the Department, Bureau, export contractors and upstream Sacramento Valley water users under which the parties have agreed to develop additional supplies of water for local use, for Delta protection, and for State Water Project and federal Central Valley Project use. The Department and the Bureau are responsible for funding the preparation of a draft Environmental Impact Report and an Environmental Impact Statement, respectively, that is required before approving actions to implement the settlement. However, work on the environmental document is on hold pending discussions among the various parties regarding how to proceed.

In February 2006, the SWRCB ordered the Department and the Bureau to take corrective actions to address threatened violations of their respective water rights permits implementing the southern Delta summer water quality objective for agricultural uses. Under this action, the Department and Bureau were to provide a schedule to the SWRCB of the proposed construction and operation of permanent operable gates in the southern Delta to help improve water quality. Other requirements of the enforcement action addressed the extent of the obligations of the State Water Project and federal Central Valley Project to protect water quality in the southern Delta. In response to a lawsuit filed against the SWRCB by the Bureau, certain Contractors and certain federal water contractors, the SWRCB clarified the enforcement order and the parties to the lawsuit entered into a stipulation for dismissal without prejudice and a tolling agreement, which extends to April 30, 2018. In addition, a June 2009 federal biological opinion for salmon, steelhead trout and green sturgeon states that the Department shall not implement the permanent operable gates because that project would adversely modify critical habitat. As a result, in January, 2010, the SWRCB issued an order that modified its February 2006 enforcement order by, among other things, allowing the Department and the Bureau to defer the construction of the permanent operable gates and requiring the Department and the Bureau to develop a plan (“South Delta Salinity Management Plan”) for studies and other measures to address water quality in the southern Delta until the SWRCB issues a new water quality control plan and related water rights decision for the Delta. In December 2016, the Delta watermaster issued a letter informing the Department of his interpretation of the enforcement order that an updated South Delta Salinity Management Plan is due by June 20, 2017. An updated plan is currently being developed.

In December 2007, the SWRCB adopted a resolution setting out a process for the review of beneficial uses in the Delta in response to scientific studies showing a decline in native species and in support of the current efforts of the Bay Delta Conservation Plan Steering Committee and Delta Vision Task Force to develop plans to improve the Delta ecosystem. See “STATE WATER PROJECT WATER SUPPLY – Long-Term Planning Efforts for the Delta,” “– *The Delta Vision*” and “– *Bay Delta Conservation Plan*.” In accordance with the resolution, in July 2008 the SWRCB adopted the Strategic Workplan for Activities in the San Francisco Bay/Sacramento-San Joaquin Delta Estuary (the “Strategic Workplan”) that describes a number of activities the SWRCB and Regional Water Quality Control Boards intend to pursue to address the water supply and environmental situation in the Bay-Delta. The Strategic Workplan activities are responsive to priorities identified by the Delta Vision Task Force, build on existing processes, such as the Bay Delta Conservation Plan, and identify a wide range of flow-related and water quality actions to better protect the Bay-Delta. The Strategic Workplan includes plans to review and update the 2006 Plan and to review the Bay Delta Conservation Plan, water rights, and other requirements to protect fish and wildlife beneficial uses. In February 2009, in furtherance of the Strategic Workplan, the SWRCB began the process to review and update the southern Delta salinity and San Joaquin River flow objectives, and their program of implementation. As part of this process, the SWRCB prepared an environmental document to evaluate the effects of potential modifications to the southern Delta salinity and San Joaquin River flow objectives and is considering adopting related amendments to the 2006 Plan. The initial environmental document received substantial public comment and a revised version was released by the SWRCB in September 2016. In January 2012, also in furtherance of the Strategic Workplan, the SWRCB began the process to review and update the other aspects of the 2006 Plan, which will include an environmental review of the effects of any proposed changes to the 2006 Plan. A draft scientific basis report was released by the SWRCB in October 2016 and is undergoing public and technical review.

In September 2010, three environmental groups filed a lawsuit against the SWRCB and the Department in State court, challenging the Department’s operations in the Delta on a variety of theories, including alleged violations of the public trust doctrine, D 1641 and the State Constitutional provision regarding reasonable use of water. The complaint claims that these violations have led to the recent decline of certain Delta fish species. The plaintiffs are asking the Court to declare that the SWRCB and the Department have violated the provisions and doctrine cited in the complaint and to enjoin the Department from diverting water from the Delta while these alleged violations persist. This lawsuit is in the process of being dismissed for failure by the environmental groups to move the case forward.

In June 2015, four environmental organizations filed a lawsuit in federal court against the Bureau claiming its operations in the Delta violate, among other things, D 1641 and the federal Clean Water Act. The SWRCB and the Department have been named in this lawsuit as real parties in interest. In July 2015, one of the four environmental organizations filed a complaint with the SWRCB against the Department and Bureau alleging violations of, among other things, D 1641 and water quality control plan standards, and requesting the SWRCB to take action to address the alleged violations. In addition, in August 2015 three of the same four environmental groups filed a petition for writ of mandate in State court seeking to have the SWRCB’s April 6, 2015, order relaxing salinity and other Delta water quality standards set aside on grounds that it violated, among other laws, the Clean Water Act, the Public Trust Doctrine and both the State and federal Endangered Species Acts. The Department and the Bureau are named as real parties in interest in the suit. In August 2015, a different environmental organization filed a complaint challenging the SWRCB’s issuance of the orders under similar theories to the lawsuit described above. The lawsuits challenging the SWRCB’s order are pending. And, in April 2016, three environmental groups filed a lawsuit against the U.S. Environmental Protection Agency in federal court alleging that the EPA failed to comply with its duty under the federal Clean Water Act to review and take appropriate action regarding the SWRCB’s revisions to the Water Quality Control Plan. The complaint alleges that the revisions to the Water Quality Control Plan made during the drought are injurious to fish.

In July 2011, an organization representing 27 Contractors filed a lawsuit against the SWRCB and the Central Valley Regional Water Quality Control Board challenging an amendment to the Sacramento-San Joaquin Delta Basin Plan, a regional water quality plan, regarding the control in the Delta of methylmercury, a chemical which can be harmful to fish. The amendment, among other things, assigns certain responsibilities jointly to the Department (with regard to both the State Water Project and the Department's flood management programs), the Central Valley Flood Protection Board, the State Lands Commission, the Bureau and the U.S. Army Corps of Engineers to control methylmercury in the open waters of the Delta in two phases. Phase I, which lasts for up to nine years, emphasizes studies and pilot projects to control methylmercury and Phase II requires implementation of measures to achieve required methylmercury levels by 2030. The Department was named as a real party in interest in the lawsuit. The Contractors contend that since the State Water Project activities do not add or introduce methylmercury into the open waters of the Delta, there is no basis in law for assigning such responsibility to the Department in its capacity as operator of the State Water Project. In March 2013, the lawsuit was dismissed with the agreement of the parties that the plaintiffs may re-file the lawsuit in the future.

Federal Endangered Species Act: General. The Department joins the Bureau in consultations with the U.S. Fish and Wildlife Service ("USFWS") and the National Oceanic and Atmospheric Administration-Fisheries ("NOAAAF") regarding the impacts to endangered fish species from the operations of the State Water Project and federal Central Valley Project. This process results in the issuance of biological opinions pursuant to the Endangered Species Act ("ESA"). These biological opinions update, extend, and consolidate prior opinions and authorize the incidental taking of the listed species of fish by the two projects. Biological opinions are generally valid until changed conditions or new listings of species would require re-initiation of consultation.

Federal Endangered Species Act: Delta Smelt. In December 2008, the USFWS issued a biological opinion for Delta smelt and related water projects operations ("2008 Biological Opinion"), which superseded a previously issued Delta smelt biological opinion. The issuance of the 2008 Biological Opinion is now the operation-criteria for the State Water Project and federal Central Valley Project. The 2008 Biological Opinion requires operational measures to protect Delta smelt and, in addition, includes a measure specifying outflow requirements in the Delta during the fall season in wet years. This fall measure requires the two water projects to control salinity incursion in the Delta through increased water releases from water storage and fewer water diversions during wet years. In August 2016, the Department and Bureau requested reinitiation of ESA Section 7 consultation with the USFWS because of the continued decline of Delta smelt, impacts from recent droughts and evolution of science in the area. The consultation is underway and anticipated to be completed in 2022 with the issuance of a new biological opinion.

Federal Endangered Species Act: Salmon, Steelhead Trout and Green Sturgeon. In June 2009, following consultation with the Department and Bureau, NOAAF issued a new salmon, steelhead trout and green sturgeon biological opinion ("2009 Biological Opinion"), which superseded a previously issued biological opinion for these fish species. The 2009 Biological Opinion imposes restrictions on the Department's pumping and operational activities in the Delta based upon the level of flows from the San Joaquin River and the presence of salmon and steelhead trout in the vicinity of the Delta pumping plant. In August 2016, the Department and Bureau requested reinitiation of ESA Section 7 consultation with the NOAAF because of the continued decline of salmon, steelhead trout and green sturgeon, impacts from recent droughts and evolution of science in the area. The consultation is underway and anticipated to be completed in 2022 with the issuance of a new biological opinion.

Federal Endangered Species Act: Longfin Smelt. In April 2012, the USFWS found that the longfin smelt warrants consideration for protection under the ESA, but that it is currently precluded from listing the species because of the need to address other higher priority species. As a result, the USFWS has added the longfin smelt to the list of candidates for ESA protection, where the status will be reviewed annually. In the meantime there will be no specific restrictions regarding the longfin smelt imposed under the ESA. The longfin smelt is listed as threatened under the California Endangered Species Act ("CESA") and the Department is already taking actions

to protect the longfin smelt consistent with the take permit the Department received from the California Department of Fish and Wildlife (the “DFW”). DWR’s CESA take permit will expire in 2018 and DWR is currently working on a new permit application. See “STATE WATER PROJECT WATER SUPPLY – State and Federal Regulations Affecting the State Water Project – *State Endangered Species Act*.”

State Endangered Species Act. To obtain the authority under the CESA to “take” Delta smelt and salmon, the Department requested a “consistency determination” from DFW for the 2008 Biological Opinion and for the 2009 Biological Opinion. In July 2009, DFW issued its determination that the 2008 Biological Opinion was consistent with CESA and in September 2009, that the 2009 Biological Opinion was consistent with CESA. See “STATE WATER PROJECT WATER SUPPLY – State and Federal Regulations Affecting the State Water Project – *Federal Endangered Species Act: Delta Smelt*” and “– *Federal Endangered Species Act: Salmon, Steelhead Trout and Green Sturgeon*.”

In March 2009, the California Fish and Game Commission also formally listed the longfin smelt, which resides in the Delta, as a threatened species under CESA. The DFW has granted the Department an incidental “take” permit for longfin smelt under CESA, which will continue in effect through December 2018. The permit incorporates the 2008 Biological Opinion for Delta smelt as an element of the take permit for longfin smelt. As a result, under most conditions, when certain flow restrictions for the protection of Delta smelt are being implemented, the permit imposes no additional requirements for the protection of adult longfin smelt. However, under the permit, the presence of adult or larval longfin smelt at certain locations during certain times of the year could cause a reduction in water deliveries.

Both the consistency determinations for Delta smelt and salmon and the incidental take permit for longfin smelt incorporate conditions from the federal Biological Opinions for Delta smelt and salmon. The Department monitors activities in the federal cases and works with DFW to assure that the Department retains CESA compliance for its State Water Project operations. See “STATE WATER PROJECT WATER SUPPLY – State and Federal Regulations Affecting the State Water Project – *Federal Endangered Species Act: Delta Smelt*” and “– *Federal Endangered Species Act: Salmon, Steelhead Trout and Green Sturgeon*.”

Long-Term Planning Efforts for the Delta

The activities and programs described in this section “Long-Term Planning Efforts for the Delta” build on prior activities and programs, including the CALFED Bay-Delta Program begun in 1995 with the participation of various State and federal agencies, as well as California’s environmental, urban and agricultural communities, to develop long-term, collectively-negotiated solutions to the environmental and water management issues concerning the Delta.

The Delta Vision. In 2006 Governor Arnold Schwarzenegger established a task force to develop a long-term sustainable vision for the Delta. The task force issued a Delta Vision strategic plan in November 2008 and an implementation report for the strategic plan in January 2009, which included specific recommendations to the Governor. Fundamental actions in the plan include developing a new system of dual water conveyance through and around the Delta, additional water storage projects, an emergency preparedness strategy and water conservation goals, restoring the ecosystem and establishing a Delta governance structure. The task force also created a non-profit organization, the Delta Vision Foundation, following the conclusion of their recommendations to the Governor. The new organization provides updates to the public on its view of the progress of the Delta Vision’s implementation.

Delta Stewardship Council and Related Legislation. The Delta Stewardship Council was created pursuant to the Delta Reform Act of 2009, part of a legislative package enacted in November 2009. The legislative package addressed California’s statewide water situation, with particular emphasis on the Delta. The package included an \$11.1 billion general obligation bond measure, which measure was subsequently amended,

including a reduction in the amount of bonds authorized to \$7.1 billion. This \$7.1 billion bond measure was approved by the voters in November 2014. See “STATE WATER PROJECT WATER SUPPLY – Statewide Water Considerations – Sources of Funding for Water Related Improvements” below. The Delta Stewardship Council is charged with developing and implementing a Delta Plan. The Delta Protection Commission, which is a State commission with certain land use responsibilities in the Delta, was directed in the same legislation to prepare an economic sustainability plan for the Delta and to provide information and recommendations to the Delta Stewardship Council. In 2012, the Delta Protection Commission completed the economic sustainability plan and provided its recommendations to the Delta Stewardship Council. The Delta Stewardship Council adopted the Delta Plan, along with regulations to implement the policies of the plan, in May 2013. The Council also certified the final program EIR for the Delta Plan on that date. Starting in May 2013, a number of legal actions were filed by certain federal water contractors, Contractors, local water agencies and environmental groups challenging the Delta Plan, associated regulations and the program EIR. The cases were coordinated in a single proceeding in Sacramento Superior Court. The Department has filed an amicus curiae brief in support of the Delta Stewardship Council in the litigation. In June 2016, the trial court ruled that the Delta Plan was invalid, until such time as the Delta Stewardship Council is able to remedy three specifically identified Delta Plan deficiencies. The Delta Stewardship Council and all, but one, of the other parties have filed appeals with the Court of Appeal challenging the judgements in their respective cases.

Bay Delta Conservation Plan/California WaterFix. Since 2007, an approach, known as the Bay Delta Conservation Plan (“BDCP”), and updated in 2015 with an alternative known as the California WaterFix, is being developed by the Department, the Bureau, DFW, federal fish and wildlife agencies and the state agencies that purchase water from the Department and the Bureau. The BDCP project alternatives as described in the 2013 public draft EIR/EIS are aimed at promoting the recovery of endangered, threatened and sensitive fish and wildlife species and their habitats in the Delta in a way that will also protect and restore water supplies and address water conveyance through the Delta. A formal public review draft BDCP and related draft EIR/EIS were released in December 2013. The plan and environmental review included analysis of strategies and measures to promote and improve the overall ecological health of the Delta and the species that inhabit the Delta and the analysis of water conveyance options, including conveyance through Delta channels or alternative conveyance, including a canal or tunnel. The public comment period for these draft documents closed in July 2014 and the submitted comments were reviewed. In August 2014, the Department announced that a recirculated draft BDCP and draft EIR/EIS would be published in early 2015. In April 2015, the Department and State and federal agencies announced a change in their approach to accomplishing the dual goals of improving the ecological health of the Delta and securing reliable water supplies. Under the new approach, implementation of new water conveyance facilities would be permitted under the provisions of the ESA and CESA, but not as part of a Habitat Conservation Plan or Natural Community Conservation Plan under federal and State law and large scale environmental restoration of the Delta would be implemented through a separate program designated California EcoRestore (discussed below).

In July 2015, a recirculated draft EIR/EIS was released for public review, with a comment period extending through October 2015. The recirculated draft document contained analysis of several new modifications to the alternatives analyzed in the December 2013 draft EIR/EIS. The Department has identified one of the modified alternatives as the preferred alternative. The preferred alternative, designated as California WaterFix, consists of an underground conveyance facility, three northern Delta intakes, and mitigation measures and environmental commitments to meet the requirements of CEQA, NEPA, ESA, CESA and other environmental requirements. This modified alternative does not carry forward the habitat restoration measures of the BDCP except to the extent it mitigates potential impacts of the water conveyance facilities for California WaterFix. Following completion of the public review and comment period, the Department and Bureau will prepare a final EIR/EIS. Timing of release of the final document will depend upon several factors, including the volume and nature of comments received on the draft recirculated EIR/EIS.

In August 2015 the Department and Bureau filed a joint petition with the SWRCB to add three new points of diversion and rediversion under existing water right permits. Changes to the Department's water rights are required for the construction of new intakes for the proposed California WaterFix. The hearing is being set to be conducted in two parts, the first addressing potential effects of the change on agricultural, municipal and industrial uses of water and the second focusing on fish and wildlife, recreational uses and the consideration of appropriate Delta flow criteria. The hearing on part one began in July 2016. Numerous entities/parties opposing the proposed project filed protests with the SWRCB and are participating in the hearing. The Department and the Bureau are discussing settlements with some of the entities/parties, which will reduce the number of issues in, and time expected for, the hearing. Part one is proceeding, while part two has yet to be calendared.

Separate from the California WaterFix and BDCP, the State intends to pursue more than 30,000 acres of Delta habitat restoration over the next 5 years. This new approach to improving the ecological health of the Delta has been designated California EcoRestore. Among other things, EcoRestore will implement restoration projects required by the 2008 and 2009 Biological Opinions. EcoRestore is estimated to cost \$300 million in the first four years, and includes amounts to be paid by the Contractors and federal water contractors for the costs of habitat restoration required to mitigate State and federal water project impacts pursuant to the biological opinions.

The costs of any conveyance system, if ultimately approved and constructed through the BDCP process, could be substantial. Capital costs to construct a conveyance system as envisioned by California WaterFix are estimated to be \$14.9 billion (in discounted 2014 dollars). These costs include mitigation and environmental commitments and would be paid by the Contractors and the federal water contractors benefiting from the project. Information about the BDCP, California WaterFix and EcoRestore can be found on the website of the California Natural Resources Agency. The information contained on such website is not part of this Offering Memorandum and is not incorporated herein.

Whether and/or the extent to which the California WaterFix or other alternative will be implemented, the final form of any implementation, the process and cost of any implementation, the scope and specifics of any conveyance system, the specific allocation of costs and the method of any financing are all still to be determined.

As part of the information gathering process for the BDCP, the Department sought permission to access Delta properties for the purposes of environmental surveys and geotechnical exploration. Beginning in 2008, the Department filed petitions in court to gain access to the property of owners who had not granted permission. In early 2011, the trial court allowed access for Department environmental surveys, but denied access for the geotechnical exploration, which includes drilling activities. The property owners appealed the order allowing environmental surveys on their property and the Department appealed the order denying access for geological exploration. In March 2014, the Court of Appeal affirmed the trial court's order denying the Department entry to conduct the geological activities and reversed the order granting the Department entry to conduct the environmental surveys. The California Supreme Court accepted the Department's petition for review of the Court of Appeal decision, and in July 2016 issued its decision reversing the Court of Appeal in all respects. The California Supreme Court held that the trial court may issue right of entry permits to the Department to conduct environmental surveys and geotechnical exploration and that such permits, with appropriate conditions to protect the interests of the property owners, comply with the State's eminent domain laws and the California Constitution. The case has now been remanded to the trial court.

In October 2010, the Department entered into a Fish Restoration Program Agreement with DFW to coordinate efforts regarding the Department's expenditure of funds for fish benefits. Currently the agreement is allocating \$230 million over four years (2015 through 2019) for certain habitat restoration activities. These activities are intended to be credited towards State and federal ESA habitat restoration requirements.

Central Valley and Delta Levees

General. Water delivered to Southern California through the State Water Project must traverse the Delta through channels protected by levees that are susceptible to major failures due to decay, inadequate maintenance, flooding, overtopping and seismic events. If a major levee failure were to occur in the Delta or on the Sacramento River flood control system, it could adversely affect the ability of the Department to deliver water through the Delta. In the event of such a failure, the quality of the Delta's water could be compromised from an increase in salinity and other adverse water quality conditions caused by an influx of water from the San Francisco Bay and could result in curtailing pumping of water from the Delta southward to the Central Valley and Southern California.

After Governor Arnold Schwarzenegger declared an emergency in 2006 for California's Central Valley levee system, including the Delta and Sacramento River flood control systems, and subsequent to the passage of Proposition 1E (the Disaster Preparedness and Flood Prevention Bond Act of 2006) and Proposition 84 (the Safe Drinking Water, Water Quality and Supply, Flood Control, River and Coastal Protection Bond Act of 2006), the Department, the United States Army Corps of Engineers and local flood control agencies have been working together to fund, design and construct levee improvements and repairs. The Department, through its Delta Levees Program, has funded significant repairs and improvements to the Delta levee system. In 2012, the Department, as required by statute with regard to its flood management responsibilities, completed, and the Central Valley Flood Protection Board adopted, a Central Valley Flood Protection Plan that analyzes flood risks and potential measures to address those risks in the Delta and in certain other areas of the California Central Valley. The Department is currently working to update that plan in 2017.

Statewide Water Considerations

Sources of Funding for Water Related Improvements. In 1992, Congress enacted the Central Valley Project Improvement Act (the "CVPIA"), which required, among other things, many environmental restoration studies and projects, the cost of which is to be shared by the federal government and the State. In 1994, the Department entered into a cost sharing agreement with DFW, the Bureau and the USFWS (the "Cost Sharing Agreement") for those projects. The State's cost share is approximately \$175 million and is funded by general fund appropriations, general obligation bond financing and other sources. The Department does not expect State Water Project funds to be used for such purpose.

In addition to the CVPIA, California voter-approved measures such as Proposition 13 (the Safe Drinking Water, Clean Water, Watershed Protection and Flood Protection Act, approved in 2000), Proposition 50 (the Water Security, Clean Drinking Water, Coastal and Beach Protection Act of 2002), Proposition 84 (the Safe Drinking Water, Water Quality and Supply, Flood Control, River and Coastal Protection Bond Act of 2006) and Proposition 1E (the Disaster Preparedness and Flood Prevention Bond Act of 2006) have or will require the State to undertake a variety of projects for environmental restoration, water use efficiency and conservation, water supply enhancement and reliability, ecosystem restoration, watershed protection, water conveyance, delta levee restoration and water storage planning and studies. These measures authorize the issuance of State general obligation bonds to fund such projects. Most recently, in November 2014, the voters approved Proposition 1, the Water Quality, Supply, and Infrastructure Improvement Act of 2014, which authorizes \$7.1 billion in general obligation bonds to fund various water projects and programs. These include projects and programs designed to address water quality, safety and reliability, ecosystem and watershed protection and restoration, respond to climate change, water security and drought preparedness, water recycling, groundwater sustainability, flood management and statewide water system operational improvements. Funds provided by this measure are not to be expended to pay the costs of the design, construction, operation, mitigation, or maintenance of Delta conveyance facilities.

Programmatic Considerations. To achieve additional capability of supplying water to the Contractors on a dependable basis at levels of acceptable water quality, the Department is considering additional water facilities and additional programs for reservoir and ground water storage, and conservation. Alternatives under consideration include (1) new reservoir storage north and south of the Sacramento-San Joaquin Delta, (2) Delta conveyance (i.e. the California WaterFix), (3) conjunctive operation with ground water storage in State Water Project service areas, (4) purchase of water from federal or local developments, and (5) construction of local water supply developments within State Water Project service areas.

Future Mandates Relating to the Delta. Water rights issues and environmental regulation with respect to the Delta have been an active area in recent decades. See “STATE WATER PROJECT WATER SUPPLY – State and Federal Regulations Affecting the State Water Project” and “– Long-Term Planning Efforts for the Delta” above.

Invasive Species. Zebra and quagga mussels are established in many regions of the United States. In 2007, quagga mussels were discovered in the lower Colorado River and rapidly spread through the Colorado River Aqueduct into water distribution systems and reservoirs in Southern California. In 2016, quagga mussels were discovered in the West Branch of the SWP (Pyramid Lake and Angeles Tunnel). An isolated population of zebra mussels is established in San Justo Reservoir in Central California. The mussels can clog water intakes, trash racks and other protective screens. Once established, the mussels cannot be easily eradicated using current technologies. Mussel management will result in a significant increase in the cost of operation and maintenance of water delivery systems. In addition, there can also be adverse ecological impacts. To prevent the spread of the mussels into the State Water Project, the Delta and other bodies of water and water systems, the Department has joined with DFW, as the lead agency, and other state and federal agencies on a number of activities. These include boat inspections, monitoring of water bodies and water systems and education of the public, especially boat owners and operators. In addition, the Department has developed a Rapid Response Plan, Vector Management Plan, and Long-term Mussel Management and Control Plan, as mandated by the California Fish and Game Code. In 2016, DWR implemented containment measures in the West Branch of the SWP in an effort to prevent spread to uninfested waterbodies

Climate Change. Climate change caused by human activities is having, and is likely to continue to have, an effect on California water resources, as evidenced by a reduction in mountain snowpack, a rise in sea level, and a change in the amount and seasonal timing of river flows. In the foreseeable future, more of the precipitation in California is likely to fall as rain instead of snow. This potential change in weather patterns will exacerbate flood risks and add additional challenges for water supply reliability.

Currently, the Sierra snowpack provides as much as a third of California’s water supply by accumulating snow during winter and releasing it slowly during spring and summer. Warming temperatures will cause the snowpack to melt faster and earlier, making it more difficult to store and use water released by the melting snowpack. Climate change is also expected to result in more variable weather patterns throughout California. More variability can lead to longer and more severe droughts. In addition, the sea level is expected to continue to rise, potentially threatening the existing channels within the Delta.

The Department considers the potential effects of climate change in both its project-level and long-term planning. The Department’s ability to recover costs necessary to support debt service has not been impacted by the effects of climate change, and it is not expected to impact cost recovery. Although it is clear that climate change has affected and will continue to affect the State Water Project, the precise extent of those affects and the associated costs to deal with them are difficult to predict.

WATER SYSTEM PROJECTS

Water System Projects consist of the portion of certain State Water Project facilities financed or expected to be financed with Water System Revenue Bonds. In each case, sources other than proceeds of Water System Revenue Bonds may have been used to pay certain costs of the facility, particularly those costs allocable to purposes other than water conservation and water transportation.

The following table summarizes the capital costs financed by Water System Revenue Bonds for the Water System Projects, and sets forth the capital costs to be financed for such projects from the issuance of Series 1 Notes and additional Water System Revenue Bonds as of April 15, 2017.

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**ESTIMATED CAPITAL FINANCING FROM
WATER SYSTEM REVENUE BONDS FOR EXISTING WATER SYSTEM PROJECTS
(in Millions)**

Water System Project	Capital Expenditures Series A through AW	Estimated Future Capital Expenditures ⁽¹⁾	Total Capital Expenditures ⁽⁵⁾
Powerplants:			
Small Hydro Project	\$ 46.6	\$ 0.0	\$ 46.6
Pyramid Hydroelectric Project	74.4	0.0	74.4
Alamo Project	30.4	0.0	30.4
Bottle Rock Facilities ⁽²⁾	80.2	0.0	80.2
South Geysers Project ⁽³⁾	40.9	0.0	40.9
Reid Gardner Project ⁽⁴⁾	176.2	0.0	176.2
East Branch Enlargement – Phase I	453.0	0.0	453.0
Additional East Branch Improvements	124.1	0.0	124.1
East Branch Enlargement – Phase II	7.9	0.2	8.1
Delta Pumping Plant Completion	73.6	0.0	73.6
Suisun Marsh Environmental Facilities	37.2	0.0	37.2
San Bernardino Tunnel Intake Structure	29.3	0.0	29.3
San Luis Rock Quarry	4.5	0.0	4.5
Castle Rock–Lakeville Transmission Line	6.9	0.0	6.9
Midway-Wheeler Ridge Transmission Line	10.1	0.0	10.1
Kern Water Bank	37.0	0.0	37.0
Vista del Lago Visitor Center	9.0	0.0	9.0
North Bay Aqueduct–Phase II	87.1	0.0	87.1
North Bay Aqueduct Improvements – Terminal Tanks	7.4	6.1 ⁽⁶⁾	13.5
North Bay Aqueduct Alternate Intake	0.0	545.0	545.0
Project Monitor and Control System	71.5	0.0	71.5
SWP Communications System Replacement ⁽⁵⁾	35.4	0.1	35.5
Arroyo Pasajero Program	5.0	1.6	6.6
Hyatt Pump-Turbine Refurbishment	17.9	4.6 ⁽⁶⁾	22.5
Edmonston Pump Replacement ⁽⁵⁾	24.2	14.9 ⁽⁶⁾	39.1
Delta Facilities Program	270.2	264.1	534.3
Tehachapi East Afterbay ⁽⁵⁾	69.1	16.2	85.3
Perris Dam Remediation ⁽⁵⁾	116.2	43.5	159.7
Thermalito Powerplant Cleanup and Reconstruction ⁽⁷⁾	52.4	180.5	232.9
FERC Relicensing – State Water Project ⁽⁷⁾	18.0	36.5	54.5
Facilities Reconstruction and Improvement Project	588.9	487.5	1,076.4
Project Planning Costs	112.8	36.2	149.0
Coastal Branch – Phase II	491.3	0.0	491.3
East Branch Extension – Phase I	126.0	0.0	126.0
East Branch Extension – Phase I Improvements ⁽⁵⁾	40.5	4.2 ⁽⁶⁾	44.7
East Branch Extension – Phase II ⁽⁵⁾	254.4	0.0	254.4
South Bay Aqueduct Enlargement and Improvement ⁽⁵⁾	267.2	0.0	267.2
Total Water System Projects ⁽⁸⁾	\$3,896.8	\$1,641.2	\$5,537.9

⁽¹⁾ The projections contained in this table have been prepared by the Department's management for management purposes on the basis of certain assumptions, and consistent with certain requirements of the Water Supply Contracts. The projections are the responsibility of the Department. GALLINA LLP has neither examined nor compiled such projections and, accordingly, GALLINA LLP does not express an opinion or provide any other form of assurance with respect thereto. The audit report included in Appendix A of this Offering Memorandum relates to the State Water Project's historical financial information. The report does not extend to the projections set forth above and should not be read to do so. These projections were not prepared with a view toward compliance with the guidelines established by the American Institute of Certified Public Accountants for preparation and presentation of prospective financial information.

⁽²⁾ Sold by the Department in 2001.

⁽³⁾ Sold by the Department in 2004.

Footnotes continue on following page.

- (4) The Department's ownership interest terminated in 2013.
- (5) The original Bond Anticipation Bonds ("BABs") for East Branch Extension – Phase I Improvements and East Branch Extension – Phase II exceeded the projected expenditures. \$44.5 million of the proceeds of the Water System Revenue Bonds Series AE refunding of the BABs was redistributed from East Branch Extension – Phase I Improvements and East Branch Extension – Phase II to Communications System Replacement, Edmonston Pump Replacement, Tehachapi East Afterbay, Perris Dam Remediation, and South Bay Aqueduct Enlargement.
- (6) Projects are completed. Amounts are treated as "Estimated Future Capital Expenditures" pending reallocation.
- (7) These projects are each a project authorized under the Resolution as part of the Facilities Reconstruction and Improvement Project, the Department has decided to show these projects individually due to the estimated aggregate principal amount.
- (8) Totals may not sum due to rounding.

The Department may issue additional Water System Revenue Bonds in amounts substantially greater than the amounts described in this subsection to finance capital costs allocated to existing Water System Projects or to Water System Projects defined by supplemental resolutions to be adopted in the future. See "THE SERIES 1 NOTES – Security for the Series 1 Notes – *Outstanding Obligations*" herein.

THE WATER SUPPLY CONTRACTS

The Water Supply Contracts between the State, acting by and through the Department (references to the Department in this Section are to the Department acting in such capacity), and the 29 Contractors are substantially uniform with respect to basic terms except with respect to certain payments by Contractors for agricultural water as noted below. Copies of the Water Supply Contracts between the State and the 29 Contractors are on file at the offices of the Department and of the Treasurer in Sacramento, and reference is made thereto for information with respect to all of the terms and conditions thereof. The following discussion, except as noted, is applicable to each of the 29 Water Supply Contracts, and assumes the effectiveness of the amendments described below under the heading "Monterey Amendment." All but two of the Contractors (Plumas County Flood Control and Water Conservation District and Empire West Side Irrigation District) have signed the Monterey Amendment.

Basic Contract

Term. The Water Supply Contracts are to remain in effect for the longest of 75 years, December 31, 2035 or until all bonds issued to finance construction costs of State Water Project facilities have been repaid, whichever period is longest, subject to an election on the part of each Contractor to receive continued service after such longest period on certain specified continued terms and conditions and other reasonable and equitable terms mutually agreed upon by the Department and the Contractor. See "THE WATER SUPPLY CONTRACTS – Contract Extension Negotiations."

Annual Table A Amounts. The year of initial water delivery is estimated in each Water Supply Contract and a table (titled "Table A") in each of the Water Supply Contracts sets forth the maximum annual amounts of water the Contractor may request to be delivered ("Annual Table A Amount") commencing in the initial year. These scheduled amounts increased yearly and reached the maximum Annual Table A Amount in a specified year, all Contractors reached their respective maximum Annual Table A Amounts on or before January 1, 2016. The Annual Table A Amounts schedule may be changed upon request by the Contractor and approval by the Department, but no such change may be made if it would impair the financial feasibility of the State Water Project.

The Annual Table A Amounts of all 29 Contractors totals 4,172,686 acre-feet of water. See "STATE WATER PROJECT WATER SUPPLY." Water delivered to a Contractor may not be disposed of by the Contractor for use outside the Contractor's territory, subject to certain limited exceptions, without the Department's consent. Restrictions are imposed on changes in the corporate organization of the Contractor.

Water Supply. Subject to the availability of funds, the Department is required to make all reasonable efforts consistent with sound fiscal policies, reasonable construction schedules, and proper operating procedures to complete the facilities necessary for water deliveries at the time and in the amounts specified.

The Department must make all reasonable efforts to perfect and protect necessary water rights and must report at least every five years on its ability to meet future water demands.

If the Department cannot complete construction of the aqueducts necessary to deliver water to the Contractor, the Contractor may, under specified circumstances, provide money to the Department necessary to enable the Department to complete construction. In such case, the Department will own and operate the aqueducts, and the amount provided by the Contractor will be credited by the Department against the Contractor's payment obligation under the Water Supply Contracts. Alternatively, the Contractor may connect, at its own expense, to the portion of the aqueduct completed by the Department to receive water to which it is entitled under the Water Supply Contract.

The Department is required to take all reasonable measures to make available water that meets the water quality objectives set forth in the Water Supply Contract.

Allocation of Water Surpluses and Deficiencies. If there is a supply of water in excess of (i) the scheduled deliveries under Table A for all Contractors and (ii) the operational requirements of the State Water Project, Contractors may purchase such surplus water on an interruptible basis. The price of this interruptible water is the incremental cost of delivery.

The Water Supply Contracts also contain provisions for the allocation of water in the event of shortages in water supply. For Contractors that have accepted the Monterey Amendment, the available supply is to be allocated in proportion to Annual Table A Amounts, with reductions for agricultural Contractors and urban Contractors being made on the same basis. Contractors that have accepted the Monterey Amendment as of the date of this Offering Memorandum have over 99 percent of the maximum Table A amounts of all Contractors. See "WATER SUPPLY CONTRACT RELATED LITIGATION – Monterey Amendment Litigation."

For Contractors that have not accepted the Monterey Amendment, there will be a reduction first in the delivery of water for agricultural purposes by an amount not to exceed 50 percent in any one year or a total of 100 percent of the Annual Table A Amount for agricultural water that may be requested in any seven consecutive years. Any additional reductions required will be apportioned among all Contractors irrespective of use. In the event of a permanent shortage there will be a proportionate reduction of the Contractors' Annual Table A Amount.

Contractors may use aqueduct capacity not used for water delivered under the Water Supply Contracts to transport other water procured by them. The Department is not liable for damage arising from shortages due to causes beyond its control. The total amount of Revenues required to be paid under the provisions of the Water Supply Contracts for the payment of debt service on the Series 1 Notes and the Water System Revenue Bonds is not dependent on the amount of water available to be delivered.

Water Charges. The Water Supply Contracts in their original form provide for two charges to the Contractor: (a) a Delta Water Charge and (b) a Transportation Charge. The Off-Aqueduct Power Facilities Amendment, East Branch Enlargement Amendment, Water System Revenue Bond Amendment, Coastal Branch Extension Amendment, East Branch Extension Amendment and South Bay Aqueduct Amendment described below (collectively, the "Revenue Bond Amendments") modify the manner of calculating the charges with respect to certain facilities, including certain of the Water System Projects.

The original Delta Water Charge and Transportation Charge each consist of three components: (a) a capital cost component; (b) a minimum operation cost component (operation costs that do not vary with water deliveries); and (c) a variable operation cost component (operation costs that vary with water deliveries). Project Planning Costs are charged under the component to which the costs of the potential project being studied would be charged if such project were constructed or acquired.

The original Delta Water Charge is a charge for each acre-foot of maximum Annual Table A Amount. It is computed so as to return to the Department generally during the term of the Water Supply Contract all “reimbursable” costs of the “project conservation facilities,” together with interest thereon. The “project conservation facilities” are defined as certain categories of facilities that conserve water. Such facilities now include the Oroville facilities, the Delta facilities, the San Luis facilities and a portion of the aqueduct leading to the San Luis facilities from the Delta. “Reimbursable” costs are those costs determined by the Department to be allocable to the purposes of water conservation (or, in the case of the Transportation Charge, to water transportation). The costs and revenues of power plants that are part of the “project conservation facilities” (including the Oroville Facilities) are included in the determination of the Delta Water Charge.

The original Transportation Charge is computed so as to return to the Department during the term of the contract the “reimbursable” costs of the facilities necessary to deliver water to a Contractor, together with interest thereon. Such facilities include aqueducts, pumping plants and on-aqueduct power facilities, but do not include any of the facilities designated by the Resolution as Water System Projects, except for the Alamo Project, Small Hydro Project and Pyramid Hydroelectric Project (which are on-aqueduct power facilities) and except as the Transportation Charge is incorporated by reference in the Water System Revenue Bond Amendment. The costs of the facilities relating to each reach of aqueduct are allocated among all Contractors receiving water through that reach. Each year’s capital expenditures are allocated among the Contractors and the allocated amount is required to be paid by each Contractor, together with interest, in not more than 50 equal annual installments within the capital cost component of the Transportation Charge. (In contracts with agricultural water Contractors, these capital costs are repaid by a uniform charge per acre-foot of the Annual Table A Amount of agricultural water that may be requested, which charge is computed so as to return to the Department generally during the Water Supply Contract term such costs with interest).

The capital cost component of the Transportation Charge and all components of the Delta Water Charge are to be repaid with interest at the weighted average of the rates paid on securities issued to finance the State Water Project (except the Department’s commercial paper, the Oroville Bonds and Water System Revenue Bonds) and certain other moneys used to finance the State Water Project. The minimum and variable operation, maintenance, power and replacement cost components (the “operation cost components”) of the Transportation Charge are paid currently.

The annual net value of power produced by any power plant located on a State Water Project aqueduct is credited to all Contractors receiving water flowing through that power plant in proportion to each Contractor’s portion of the total water flowing through the plant during the year. The credit is given in the form of a reduction in the variable operation cost component of each such Contractor’s Transportation Charge.

Payment of Water Charges. On or before July 1 of each year, the Department furnishes each Contractor with a statement of estimated charges for the capital cost components (including charges under the Revenue Bond Amendments) and the operation cost components of the Delta Water Charge and the Transportation Charge for the following calendar year. The capital cost component payments of the Delta Water Charge and Transportation Charge, the revenue bond charges of the East Branch Enlargement Amendment, Coastal Branch Extension Amendment, East Branch Extension Amendment and South Bay Aqueduct Enlargement Amendment, and the revenue bond surcharge of the Water System Revenue Bond Amendment are due semiannually, on January 1 and July 1 of the year following receipt of the statement of charges. The operation cost component payments of the Delta Water Charge, Transportation Charge, East Branch Enlargement Amendment and East Branch Extension Amendment and all payment components of the Off-Aqueduct Power Facilities Amendment are due in twelve monthly installments commencing on January 1 of the year following receipt of the statement of charges.

On or about July 1 of each year, the Department determines the rate (per acre-foot) to be charged each Contractor in the following calendar year for the variable operation cost components of the Delta Water Charge and the Transportation Charge. The variable operation cost components in such calendar year are calculated and

billed monthly based on metered water deliveries for the preceding month and an updated rate determined at the beginning of such calendar year. Payment of the variable operation cost components is due on the fifteenth day of the month following receipt of the monthly statement of charges and the Department grants a 30-day grace period, which results in an approximately three-month delay between delivery of water and payment of the variable operation cost components.

On July 1 of each year, the Department furnishes each Contractor with a statement showing the difference between the estimated water charges paid and the actual costs incurred in the prior calendar year. The difference is paid by or credited to each Contractor, as applicable, in equal monthly installments commencing on January 1 of the year following the “true-up” calculation. This process results in an approximately two-year delay in the reconciliation of estimated charges paid and actual costs reimbursed to the Department.

Interest from the due date at the interest rate earned by the State’s Pooled Money Investment Account must be paid on any payment received more than 30 days after the due date. A Contractor’s failure or refusal to accept delivery of water does not relieve the Contractor of its payment obligations. A Contractor is obligated to make payments to the Department notwithstanding any individual default by its constituents, assignees or others in the payment to the Contractor of charges levied by the Contractor. In accordance with a statutory requirement, each Water Supply Contract requires that whenever the Contractor fails or is unable to raise sufficient funds by other means the Contractor must levy upon all taxable property in the Contractor’s service area a tax or assessment sufficient (with other available moneys) to provide for all payments under the Water Supply Contract.

If the Contractor defaults in payment, the Department may, and under certain conditions is required to, upon six months’ notice, suspend water deliveries during the period of default. During such period the Contractor remains obligated to make all payments required by the Water Supply Contract and the Department is not deprived of any other remedy under the Water Supply Contract or law.

Revenues from Financed Facilities

Revenues received under the Water Supply Contracts and attributable to facilities financed with the Series 1 Notes and the Water System Revenue Bonds are available to be pledged to the payment of the Series 1 Notes and the Water System Revenue Bonds, respectively, and are available to be used to pay operating expenses of such facilities. Other income and revenues derived from the Water Supply Contracts are pledged to the purposes and priorities set forth in the Burns-Porter Act, including the payment of certain operation, maintenance and replacement costs of the State Water Project, the payment of debt service on the State general obligation bonds issued under the Burns-Porter Act, the repayment of certain State moneys used for construction, and the payment of costs of acquisition and construction of the State Water Resources Development System (which includes the State Water Project).

Monterey Amendment

In December 1994, the Department and representatives of certain of the Contractors reached an agreement on comprehensive principles that served as the basis for negotiating amendments to the Water Supply Contracts. These amendments are collectively known as the “Monterey Amendment.” The Monterey Amendment was negotiated subject to the provision of the Resolution that the Department shall not agree to any amendment to the Water Supply Contracts that would materially adversely affect the security of the Water System Revenue Bonds.

Water Supply Contract provisions that have been amended or added by the Monterey Amendment include provisions relating to the allocation of water (both in the event of a shortage and in the event of surplus), the transfer of the land and related assets of the Kern Fan Element of the Kern Water Bank to Kern County Water Agency (“KCWA”), the operation of certain State Water Project reservoirs, transfers of State Water Project

Annual Table A Amounts (including certain transfers from agricultural Contractors to urban Contractors), other water transfers, the creation of and limitations on a Department reserve for operation, maintenance and replacement costs, and the description of facilities that may be financed with revenue bonds (adding a corporation yard and an operations center).

In addition, the Monterey Amendment provides for the reduction of annual Water Supply Contract charges in a manner such that Water Supply Contract revenues (taking into account other revenues and credits) are at levels calculated to meet (but not exceed) the following “revenue needs”: (1) annual financing requirements (including debt service and coverage) for revenue bonds, including the Bonds, issued for State Water Project facilities, (2) operation and maintenance expenses of the State Water Resources Development System (which includes the State Water Project, the Davis-Grunsky Act Program and the San Joaquin Drainage Program), (3) debt service on general obligation bonds issued under the Burns-Porter Act, (4) \$4.5 million per year for capital costs of the State Water Project and the San Joaquin Drainage Program for which neither general obligation bond nor revenue bond proceeds are available, and (5) after the provision of at least \$40.5 million per year of reductions in charges to the Contractors, the amounts available and needed for certain “additional State Water Resources Development System purposes.”

By August 1999, the Department had executed the Monterey Amendment with 27 of the Contractors. The Contractors that have signed the Monterey Amendment have approximately 99 percent of the maximum Table A amounts and make approximately 99 percent of the annual Water Supply Contract payments. The Department believes that it can administer the State Water Project in a manner such that both the Contractors that have not signed the Monterey Amendment and the Contractors that have signed the Monterey Amendment will receive the benefits and have the obligations provided in their respective Water Supply Contracts, amended or not as the case may be.

Pending litigation relating to the Monterey Amendment is described under “WATER SUPPLY CONTRACT RELATED LITIGATION – Monterey Amendment Litigation.”

Contract Extension Negotiations

In May 2013, the Department and the Contractors began negotiations in a public forum to develop contract amendments to extend the term and change certain financial provisions of the Water Supply Contracts. In June 2014, the negotiators for the Department and the Contractors reached a general agreement on principles for such an amendment (the “Agreement in Principle”). The Department and 25 of the Contractors have signed the Agreement in Principle. The County of Butte, the Plumas County Flood Control and Water Conservation District, the San Luis Obispo Flood Control and Water Conservation District and the Santa Barbara Flood Control and Water Conservation District have not signed the Agreement in Principle.

Currently, the Water Supply Contracts are to remain in effect for the longest of 75 years, December 31, 2035 or until all bonds issued to finance construction costs of State Water Project facilities have been repaid, whichever period is longest, subject to an election on the part of each Contractor to receive continued service after such longest period on certain specified continued terms and conditions and other reasonable and equitable terms mutually agreed upon by the Department and the Contractor. No Bonds have been sold with a maturity date later than December 1, 2035. The 75 year term provision currently results in the Water Supply Contracts having varying termination dates that range between December 31, 2035 and 2042, subject to the aforementioned election. Under the Agreement in Principle the term of the Water Supply Contract for each Contractor that signs an amendment would be extended until December 31, 2085.

Also under the Agreement in Principle, certain provisions that provide for charges to the Contractors for capital costs and certain other costs to be made on an amortized basis would be amended to provide for charges to the Contractors on an annual “pay as you go” basis to provide the revenues needed by the Department to make

payments in each year. The current provisions authorizing the Department to charge the Contractors annually for the full amount of the required annual debt service and coverage on the Bonds will continue in any extended contract. Other provisions addressed in the Agreement in Principle would provide for, among other things, an increase in the Department's operating reserves, a mechanism for financing capital projects with State Water Project funds and recovering those costs with interest from the Contractors, establishment of an account to pay for certain State Water Resources Development System expenses not chargeable to the Contractors and the establishment of a Finance Committee consisting of Department and Contractor representatives to serve as a forum for discussions and to provide a channel for recommendations to the Director of Water Resources concerning financial policies of the State Water Project.

Environmental review pursuant to CEQA and a presentation by the Department in an informational hearing to the Legislature will be part of the contract extension amendment process before any contract amendment is adopted. In August 2016, the Department released for public comment a draft EIR for the proposed contract extension amendment. The public comment period on the draft EIR closed in October 2016 and the Department is currently in the process of preparing the Final EIR. Any amendment that is ultimately adopted will comply with the Department's covenant in the Resolution not to agree to any amendment to the Water Supply Contracts which would materially adversely affect the security for the Bonds.

WATER SUPPLY CONTRACT RELATED LITIGATION

The Department is a party to several lawsuits respecting the Water Supply Contracts as described below.

Monterey Amendment Litigation

In May 2003, the trial court approved a settlement agreement among the Department and the other parties in *Planning and Conservation League, et al. vs. Department of Water Resources and Central Coast Water Authority*, a lawsuit that challenged the Monterey Amendment. Under the settlement agreement, the Department agreed, among other things, to act as lead agency in the preparation of a new EIR for the Monterey Amendment. During the preparation and processing of the new EIR, the Department was permitted under the settlement agreement to continue to operate the State Water Project in accordance with the provisions of the Monterey Amendment, including the provisions pertaining to the transfer of land and related assets of the Kern Fan Element of the Kern Water Bank to KCWA. The Department also agreed to pay for certain watershed improvements in Plumas County and to pay the plaintiffs certain amounts for use in implementing the settlement agreement. The plaintiffs agreed to limit the grounds upon which they could challenge the new EIR after it is completed.

The parties to the lawsuit had engaged in settlement discussions after the Court of Appeal, in September 2000, reversed an earlier trial court ruling on the Monterey Amendment EIR. The trial court had found that the designation of the Central Coast Water Authority, rather than the Department, as the lead agency for the Monterey Amendment EIR, violated the California Environmental Quality Act, but that the Monterey Amendment EIR was adequate, and the error as to the lead agency was harmless. As a result of the trial court's ruling, the Department had proceeded to implement the Monterey Amendment, including transferring the Kern Fan Element property to KCWA. The Court of Appeal, however, found that the Monterey Amendment EIR was inadequate in certain respects and remanded the case to the trial court to oversee the Department's preparation of a new EIR and to consider whether the Monterey Amendment may continue to be implemented while the new EIR was being prepared. The May 2003 settlement agreement described in the immediately preceding paragraph addressed these issues.

In accordance with the Court of Appeal's determination, the Department prepared a new EIR and filed its Notice of Determination in May 2010. In June 2010, two Delta water agencies and several environmental organizations and individuals filed a lawsuit in Sacramento County Superior Court challenging the Department's CEQA compliance and the validity of the Monterey Amendment, including the Department's transfer of the Kern Fan Element to the KCWA. In July 2010, the same plaintiffs in the Sacramento County Superior Court case filed

a lawsuit in Kern County Superior Court challenging the transfer of the Kern Fan Element from KCWA to the Kern Water Bank Authority, a local joint powers agency which now has responsibility for the management of the Kern Fan Element and the Kern Water Bank. In addition, in June 2010, two water districts in Kern County filed a separate lawsuit in Kern County Superior Court, challenging primarily the Department's CEQA compliance with respect to the Kern Fan Element transfer from the Department to KCWA. The two lawsuits filed in Kern County Superior Court were transferred to the Sacramento County Superior Court. In December 2012, the Department prevailed on its challenge to the plaintiffs' validation causes of action (including the validity of Kern Fan Element transfer) on the grounds that they were not timely filed. This left only the plaintiffs' CEQA compliance challenges. After holding a hearing on the CEQA challenges in the remaining two cases, the trial court ruled that most of the EIR was adequate under CEQA, but that the EIR's discussion of the impacts on continued use and operation of the Kern Water Bank was deficient. In October 2014, the trial court ordered the Department, as the remedy for the deficiency, to provide additional environmental analysis on the impacts of the continued use and operation of the Kern Water Bank and upon completion of the EIR process, to determine whether to continue the use and operation of the Kern Water Bank by the Kern Water Bank Authority. The court limited its decision to the Kern Water Bank by ruling that only those portions of the revised Monterey Plus EIR that are new or changed shall be subject to challenge under CEQA by petitioners or other interested parties and that no other challenges that were raised or could have been raised with respect to the Monterey Plus EIR may be raised in any challenge to the revised Monterey Plus EIR. The trial court's decision, therefore, leaves all matters related to the State Water Project and the Monterey Amendment untouched. In December 2014, one set of plaintiffs filed a notice of appeal with the Court of Appeal. These plaintiffs are appealing the trial court's final CEQA and validation decisions. In September 2016, the Department issued the revised EIR in compliance with the trial court's decision. Shortly thereafter, one set of plaintiffs, as well as a new party, filed a new action challenging the revised EIR. The new action challenges the Department's certification of the revised Monterey Plus EIR and approval of the "Kern Water Bank Development and Continued Use and Operation" project. The Department, however, does not expect that there would be any material adverse impact on the ability of the Department to meet its payment obligations, including those with respect to the Bonds, even if the appeal of the trial court's decisions or the new challenge to the Department's revised EIR is successful.

Tolling and Waiver Agreement with Contractors

In 2007 and 2008, the Department entered into a Tolling and Waiver Agreement with 28 of the 29 Contractors. The Contractors that have signed the Tolling and Waiver Agreement have more than 99 percent of the maximum Table A amounts and make more than 99 percent of the annual Water Supply Contract payments. The Tolling and Waiver Agreement, as amended, expires on December 31, 2017.

The Tolling and Waiver Agreement was entered into in connection with the filing by Metropolitan Water District of Southern California ("Metropolitan") in December 2005, of a Notice of Contest with the Department challenging various charges in the Department's bills to Metropolitan. One of the claims made by Metropolitan was that the Department was using a portion of Series 1 Note and Water System Revenue Bond proceeds to finance certain capital costs attributable to recreation and fish and wildlife enhancement that are a part of or are related to certain facilities properly financed by such notes and bonds ("Recreation Costs") and that the Department was not authorized to charge the Contractors for such Recreation Costs.

The Department investigated the claim regarding Recreation Costs and determined that it had used a portion of the proceeds of certain Series 1 Notes and Water System Revenue Bonds to finance Recreation Costs and was not authorized to charge the Contractors for such costs. As a result, the Department revised the bills to the Contractors and defeased the outstanding portion of the Series 1 Notes and Water System Revenue Bonds that had been applied to Recreation Costs. To facilitate the accomplishment of these actions, the signing Contractors agreed to waive and release certain claims in the Tolling and Waiver Agreement related to such actions. The Department no longer allocates proceeds of Series 1 Notes or Water System Revenue Bonds to recreation or fish and wildlife enhancement costs.

The Tolling and Waiver Agreement, as amended, also tolls (i.e., suspends) until December 31, 2017, the running of the time period and statute of limitations for filing by the Contractors of (1) protests regarding the Department's bills to the Contractors for 2007 through 2018, (2) claims arising from the Department's revisions to prior year invoices that were made to adjust for improper charges to the Contractors for recreation and fish and wildlife enhancement costs, and (3) certain other specified claims.

No assurance can be given that Contractors will not file additional Notices of Contest, claims and/or lawsuits with respect to such restatements of the amount of reductions in charges under the Monterey Amendment.

THE CONTRACTORS

The 29 Contractors are principally located in the San Francisco Bay area, the Central Coast, the Central Valley and Southern California and their service areas encompass approximately 39,200 square miles, approximately 25 percent of the State's land area, with a population of approximately 26 million, or about 69 percent of the State's population.

With three exceptions, the Contractors are established as districts under various State statutes providing for the formation of districts for water-related purposes. One Contractor is a city and two are counties. Of the 29 Contractors, 24 provide water primarily for municipal and industrial purposes and five provide water primarily for agricultural purposes.

The State Water Project was designed to be a supplemental source of water for Contractors, not an exclusive source, and Contractors have various other sources of water supply.

Certain of the Contractors also provide other services, including flood control, ground water replenishment, sewage collection and disposal, solid waste and trash collection and disposal, hydroelectric power generation and first aid, ambulance and paramedical services.

Governing Bodies

Eight of the Contractors are governed by county boards of supervisors, 19 by elected boards of directors, and one by its city council. Metropolitan's board of directors consists of representatives appointed by the governing bodies of its constituent public agencies. Boards of supervisors generally include five members who are elected by popular vote. Specially elected governing boards generally include between five and eleven members and are elected by registered voters except for a few districts in agricultural areas, where the vote is based upon ownership of land in the district.

Water Rates and Taxation

Rates and charges of the Contractors are generally set by each Contractor's governing body and are not presently subject to any state or federal regulatory agency.

Many Contractors receive a major portion of their income from *ad valorem* taxes on property and some make all payments under their Water Supply Contracts from *ad valorem* taxes. The ability of Contractors to tax for general purposes and to appropriate for general purposes from tax revenue is limited under California law.

Selected Contractor Data

The table entitled “Selected Data on the Contractors” sets forth for each Contractor the year in which it was established, its estimated population and principal water-related activities.

SELECTED DATA ON THE CONTRACTORS

Contractor	Year Established	Estimated December 31, 2016 Population	Principal Water Related Activities
Alameda County Flood Control and Water Conservation District, Zone 7	1967	238,600	Treats, distributes, and stores State water for municipal and agricultural purposes.
Alameda County Water District	1913	348,600	Treats and distributes State water for municipal purposes. Uses State water to replenish ground water basins for municipal and agricultural purposes as well as for salt water barrier protection for ground water basins.
Antelope Valley-East Kern Water Agency	1959	397,634	Distributes State water for agricultural purposes. Treats and distributes State water for municipal purposes.
Castaic Lake Water Agency	1962	275,820	Treats and distributes State water for municipal purposes.
City of Yuba City	1908	71,070	Treats and distributes State water for municipal purposes.
Coachella Valley Water District	1918	286,000	Exchanges State water for water from Metropolitan for storage in underground basins and for distribution for agricultural purposes.
County of Butte	1850	204,000	Distributes State water for municipal purposes.
County of Kings	1893	149,942	Exchanges State water for water from the Tulare Lake Basin Water Storage District for recreational purposes.
Crestline-Lake Arrowhead Water Agency	1962	29,000	Treats and distributes State water for municipal purposes.
Desert Water Agency	1961	106,000	Exchanges State water for water from Metropolitan for storage in underground basins and distribution for municipal purposes.
Dudley Ridge Water District	1963	36	Distributes State water for agricultural purposes.
Empire West Side Irrigation District	1931	12	Distributes State water for agricultural purposes. Exercises surface water rights.
Kern County Water Agency	1961	882,176	Distributes State water to 16 districts for agricultural and municipal use. Replenishes ground water basins with State water for municipal and agricultural use. Exercises flood control functions.
Littlerock Creek Irrigation District	1892	2,900	Distributes State water for agricultural purposes.
The Metropolitan Water District of Southern California	1928	18,800,000	Transmits and distributes State water and water from the Colorado River to 27 public agencies for municipal, agricultural and ground water replenishment purposes.
Mojave Water Agency	1960	476,799	Distributes State water for municipal purposes and uses State water to replenish ground water basins.
Napa County Flood Control and Water Conservation District	1951	139,099	Distributes water for municipal purposes. Exercises flood control functions.
Oak Flat Water District	1964	10	Distributes State water for agricultural purposes.
Palmdale Water District	1918	114,533	Treats and distributes State water for municipal purposes.
Plumas County Flood Control and Water Conservation District	1967	21,200	Distributes State water. Exercises flood control functions.
San Bernardino Valley Municipal Water District	1954	661,546	Uses State water to replenish ground water basins and for municipal purposes.
San Gabriel Valley Municipal Water District	1959	197,636	Uses State water to replenish ground water basins.

Contractor	Year Established	Estimated December 31, 2016 Population	Principal Water Related Activities
San Geronio Pass Water Agency	1961	78,268	Uses State water to replenish ground water basins and for municipal purposes.
San Luis Obispo County Flood Control and Water Conservation District	1945	279,083	Has contracted for State water. Exercises flood control functions.
Santa Barbara County Flood Control and Water Conservation District	1956	373,906	Has transferred its rights under its Water Supply Contract to the Central Coast Water Authority, which will distribute State water for municipal purposes. Exercises flood control functions.
Santa Clara Valley Water District	1951	1,903,974	Treats and distributes State water for municipal purposes. Distributes State water for agricultural purposes and for replenishment of ground water basins. Exercises flood control functions.
Solano County Water Agency	1958	440,207	Distributes State water for municipal purposes. Exercises flood control functions.
Tulare Lake Basin Water Storage District	1926	23	Distributes State water for agricultural purposes. Exercises surface water rights.
Ventura County Flood Control District	1944	472,776	Purchases State water and sub-contracts the entire amount to Casitas Municipal Water District. While Casitas manages the facility, Ventura County has primary responsibility for payment for State water. Exercises flood control functions.
Total		<u>26,950,850</u>	

Source: Department of Water Resources, State Water Project Analysis Office.

Water Deliveries and Contractor Payments

The table on the following page shows, for the last five calendar years, historical water deliveries from the State Water Project to each Contractor.

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Historical Deliveries of Water from the State Water Project to the Contractors⁽¹⁾
(in acre-feet)

Contractor	2012	2013	2014	2015	2016	Maximum Table A Amount⁽²⁾
Alameda County Flood Control and Water Conservation District, Zone 7	55,239	44,954	34,122	32,444	53,484	80,619
Alameda County Water District.....	20,831	23,640	30,066	27,259	27,357	42,000
Antelope Valley-East Kern Water Agency	111,207	51,003	18,532	14,308	41,356	141,400
Castaic Lake Water Agency.....	50,473	44,754	29,448	29,189	37,828	95,200
City of Yuba City	2,695	4,850	4,237	3,004	1,229	9,600
Coachella Valley Water District	117,587	66,539	12,750	37,596	69,422	138,350
County of Butte	1,374	908	1,652	2,763	2,518	27,500
County of Kings.....	7,405	4,645	1,386	1,229	3,660	9,305
Crestline-Lake Arrowhead Water Agency.....	624	1,368	1,260	1,253	1,084	5,800
Desert Water Agency.....	45,101	20,791	3,005	11,217	21,893	55,750
Dudley Ridge Water District	30,450	32,770	36,162	41,733	19,308	50,343
Empire West Side Irrigation District	2,242	1,567	516	624	1,822	3,000
Kern County Water Agency	810,029	744,317	518,021	520,758	638,926	982,730
Littlerock Creek Irrigation District	-	-	-	-	-	2,300
The Metropolitan Water District of Southern California	1,224,907	892,550	387,556	573,526	1,083,900	1,911,500
Mojave Water Agency.....	11,244	7,498	3,581	8,830	22,284	82,800
Napa County Flood Control and Water Conservation District..	9,904	12,478	14,237	11,199	8,993	29,025
Oak Flat Water District.....	3,208	2,820	1,520	1,077	1,855	5,700
Palmdale Water District.....	18,897	10,567	8,406	5,836	10,516	21,300
Plumas Co. Flood Control and Water Conservation District	79	366	251	730	387	2,700
San Bernardino Valley Municipal Water District	112,972	32,085	11,182	24,380	62,676	102,600
San Gabriel Valley Municipal Water District.....	22,058	9,252	1,200	5,760	16,088	28,800
San Geronio Pass Water Agency	11,010	9,445	5,044	3,481	10,816	17,300
San Luis Obispo Co. Flood Control and Water Conserv. Dist..	3,944	3,681	3,206	3,473	4,199	25,000
Santa Barbara Co. Flood Control and Water Conserv. Dist. ⁽³⁾ ..	19,474	18,018	16,757	11,638	34,085	45,486
Santa Clara Valley Water District.....	63,794	84,623	66,846	82,888	107,164	100,000
Solano County Water Agency	29,350	35,929	19,679	23,836	23,605	47,756
Tulare Lake Basin Water Storage District	95,717	48,361	8,316	17,336	42,387	88,922
Ventura County Flood Control District	4,353	2,890	93	1,000	3,000	20,000
TOTAL.....	2,886,168	2,212,669	1,239,031	1,498,367	2,351,842	4,172,786

⁽¹⁾ Historical deliveries reflect changes resulting from the reclassification of water to or from these water types; flexible withdrawal, Non-State Water Project local water rights, or Non-State Water Project water. Water delivered to Contractors includes, but is not limited to, Table A water; Table A water allocated to a previous year (carryover); water surplus to operational needs; water quality, and Delta requirements; transfer; purchased; and non-State Water Project water.

⁽²⁾ Reflects permanent transfers of Table A amounts through December 31, 2016. For an explanation of Table A amounts see "THE WATER SUPPLY CONTRACTS- Basic Contract- Annual Table A Amounts."

⁽³⁾ As of July 1, 1989, Santa Barbara County FCWCD transferred certain of its rights under its Water Supply Contract to certain local water purveyors and users within Santa Barbara County. Thereafter, on September 26, 1991, the local water purveyors and users transferred those rights to the Central Coast Water Authority in consideration for its agreement to provide for the delivery of water under the related Water Supply Contract to the local water purveyors and users. Although the Department did not object to these transfers, the Department considers Santa Barbara County FCWCD to be the party to which the Department is obligated under the Water Supply Contract, and the Department did not release Santa Barbara County FCWCD from its Water Supply Contract obligations.

Source: Department of Water Resources, State Water Project Analysis Office.

Payment History

The Department has not experienced payment delinquencies or defaults by Contractors that have had a materially adverse effect on the maintenance or operation of the State Water Project, or the ability of the Department to pay its obligations when due. Under the Water Supply Contracts, if a Contractor defaults in payment, the Department may, and under certain conditions is required to, upon six months' notice, suspend water deliveries during the period of default. In accordance with a statutory requirement, each Water Supply Contract requires that whenever the Contractor fails or is unable to raise sufficient funds by other means the Contractor must levy upon all taxable property in the Contractor's service area a tax or assessment sufficient (with other available moneys) to provide for all payments under the Water Supply Contract.

COMMERCIAL PAPER RATINGS

S&P Global Ratings ("S&P") and Moody's Investors Service ("Moody's") have assigned the Series 1 Notes offered hereby commercial paper ratings of A-1+ and P-1, respectively. Such ratings are based in part upon information provided by the Department. Each rating reflects only the views of the applicable rating agency, and an explanation of the significance of such rating may be obtained only from such rating agency. Such ratings are not a recommendation to buy, sell or hold the Series 1 Notes. There can be no assurance that either such rating will continue for any given period of time or that it will not be revised downward or withdrawn entirely if, in the judgment of the applicable rating agency, circumstances so warrant. Any such change in or withdrawal of either such rating could have an adverse effect on the market price or marketability of the Series 1 Notes.

THE CREDIT AGREEMENT

The Credit Agreement is a liquidity facility and under certain circumstances, the obligation of the Bank to make loans pursuant to the Credit Agreement will immediately terminate or be suspended and the Bank may suspend the ability of the Department to issue Series 1 Notes, and, in each case, such termination and/or suspension may occur without notice or payment to owners of the Series 1 Notes. See "THE SERIES 1 NOTES – Security for the Series 1 Notes" and "Events of Default" and "Remedies" below.

General Terms

Pursuant to the Credit Agreement, Bank of America, N.A. (the "*Bank*"), has agreed to extend to the Department a liquidity facility in the form of a revolving line of credit to provide liquidity, if necessary and subject to certain conditions, for the payment of the principal of and accrued interest on any Series 1 Notes at the stated maturity thereof in accordance with the terms of the Credit Agreement. Under the Credit Agreement, the Bank is, subject to certain terms and conditions, obligated to provide up to \$322,191,781 for the purposes set forth therein.

The principal amount of Series 1 Notes paid by the Bank will be limited to \$300,000,000, allowing for \$22,191,781 of accrued interest thereon, which constitutes 270 days of interest at 10% on such maximum principal amount calculated on the basis of actual number of days and a 365 day year.

The Credit Agreement is scheduled to expire on the earliest of (i) May 1, 2020, (ii) the date the Commitment (as defined in the Credit Agreement) is reduced to zero pursuant the terms of the Credit Agreement and (iii) the Business Day (as defined in the Credit Agreement) immediately succeeding the Substitution Date (as defined in the Credit Agreement) but can be extended upon written request by the Department and approval of the Bank, and may terminate earlier as described below.

Events of Default

Each of the following events shall constitute an "Event of Default" under the Credit Agreement:

(a) the Department shall fail to pay (i) any principal of or interest on any Loan (as defined in the Credit Agreement) or Bank Note (as defined in the Credit Agreement) when due (whether by scheduled maturity, required prepayment, acceleration, demand or otherwise) (other than payments on Loans or the Bank Note due solely as a result of acceleration caused by the Bank, pursuant to the Credit Agreement), or (ii) any Facility Fee (as defined in the Credit Agreement) or any other amount payable thereunder and, in the case of such Facility Fee or other amount, such failure shall continue for a period of three Business Days from the date such obligation was due;

(b) any representation, warranty, certification, or statement made by the Department (or incorporated by reference) in the Credit Agreement, any other Related Document (as defined in the Credit Agreement) or in any certificate, financial statement, or other document delivered pursuant to the Credit Agreement or any Related Documents shall have been incorrect or untrue or misleading in any material respect when made or deemed to have been made;

(c) the Department shall fail to perform or observe any of the certain specified covenants, agreements or conditions contained in the Credit Agreement;

(d) the Department shall fail to perform or observe any other covenant, agreement, or condition (other than those referred to or described in the immediately preceding paragraphs (a), (b), or (c) under the heading "Events of Default" above) contained in the Credit Agreement, the Bank Note or any other Related Document and such failure, if capable of being remedied, shall remain unremedied for 30 days after the earlier to occur of (i) written notice thereof shall have been given to the Department by the Bank or (ii) the date on which such failure shall first become known to the Department;

(e) (i) one or more final unappealable judgments or orders, issued or rendered by a Government Authority (as defined in the Credit Agreement) of competent jurisdiction, for the payment of money in excess of \$25,000,000, individually or in the aggregate, shall be issued or rendered against the Department, and such judgment or order shall continue unsatisfied, unbonded, undismissed and unstayed for a period of 60 days; or (ii) one or more final unappealable judgments or orders or writ or writs or warrant or warrants of attachment, or any similar process or processes issued or rendered by a Government Authority of competent jurisdiction, for the payment of money in excess of \$25,000,000, individually or in the aggregate, shall be issued or rendered against the Department (but only with respect to writ or writs or warrant or warrants of attachment, or any similar process or processes) or any of the Department's Property (as defined in the Credit Agreement) and remain unpaid, unvacated, unbonded or unstayed for a period of 60 days;

(f) (i)(A) the Department shall fail to pay when due and payable any principal of or interest on any Specified Debt (as defined in the Credit Agreement) (including, in each case, without limitation, any principal or sinking fund installments, but excluding, in each case, (i) payments due on Specified Debt owing to a liquidity provider under a liquidity facility solely as a result of acceleration caused by such liquidity provider with respect to such Specified Debt and (ii) any Specified Debt which is in the form of commercial paper notes which are supported as to the payment of principal and/or interest thereof by a credit enhancement or liquidity facility if such failure to make such payment is due solely to the failure of the related credit enhancement or liquidity facility provider to make such payment), and such failure shall continue beyond any applicable period of grace specified in any underlying indenture, contract or instrument providing for the creation of or concerning such Specified Debt; or (B) any other default under any indenture, contract or instrument providing for the creation of or concerning such Specified Debt, or any other event, shall occur and shall continue after the applicable grace period, if any, specified in such agreement or instrument, if the effect of such default or event is to accelerate, or to permit the acceleration of, the maturity of such Specified Debt (ii) the Department shall fail to pay when due and payable any principal of or interest on any Senior Lien Obligations (as defined in the Credit Agreement) or any Parity Debt (as defined in the Credit Agreement) other than as described in the foregoing clause (i) of this paragraph (f) (including, in each case, without limitation, any principal or sinking fund installments), and such

failure shall continue beyond any applicable period of grace specified in any underlying indenture, contract or instrument providing for the creation of or concerning such Senior Lien Obligations or Parity Debt; or any other default under any indenture, contract or instrument providing for the creation of or concerning such Senior Lien Obligations or Parity Debt, or any other event, shall occur and shall continue after the applicable grace period, if any, specified in such agreement or instrument, if the effect of such default or event is to accelerate, or to permit the acceleration of, the maturity of such Senior Lien Obligations or Parity Debt, or (iii) (A) the Department shall fail to pay when due and payable any principal of or interest on any other Debt (as defined in the Credit Agreement) of the Department having a principal amount in excess of \$25,000,000 and such failure shall continue beyond any applicable period of grace specified in any underlying indenture, contract or instrument providing for the creation thereof, or (B) any other default under any indenture, contract or instrument providing for the creation of or concerning such other Debt, or any other event, shall occur and shall continue after the applicable grace period, if any, specified in such agreement or instrument, if the effect of such default or event is to accelerate, or to permit the acceleration of, the maturity of such other debt;

(g) (i) the Department shall commence any case, proceeding or other action (A) under any existing or future law of any jurisdiction, domestic or foreign, relating to bankruptcy, insolvency, reorganization or relief of debtors, seeking to have an order for relief entered with respect to it, or seeking to adjudicate it a bankrupt or insolvent, or seeking reorganization, arrangement, marshaling of assets, adjustment, winding-up, liquidation, dissolution, composition or other relief with respect to it or its debts or (B) seeking appointment of a receiver, trustee, examiner, liquidator, custodian or other similar official for it or for all or any substantial part of its assets, or the Department shall make a general assignment for the benefit of its creditors; or (ii) there shall be commenced against the Department any case, proceeding or other action of a nature referred to in clause (i) of this paragraph (g) which (x) results in an order for such relief or in the appointment of a receiver, trustee, examiner, liquidator, custodian or similar official or (y) remains undismissed, undischarged or unbonded for a period of 60 days; or (iii) there shall be commenced against the Department, any case, proceeding or other action seeking issuance of a warrant of attachment, execution, distraint or similar process against all or any substantial part of its assets, which results in the entry of an order for any such relief which shall not have been vacated, discharged, or stayed or bonded pending appeal within 60 days from the entry thereof; or (iv) the Department shall take any action in furtherance of, or indicating its consent to, approval of, or acquiescence in, any of the acts set forth in clause (i), (ii), or (iii) of this paragraph (g) above or fail to contest in good faith any such appointment or proceeding; or (v) the Department shall admit in writing its inability to pay its debts generally as they become due, or shall become insolvent within the meaning of Section 101(32) of the United States Bankruptcy Code;

(h) (i) any provision of applicable law or the Credit Agreement, the Series 1 Notes, the Bank Note, the Issuing and Paying Agent Agreement (as defined in the Credit Agreement), the Resolution (as defined in the Credit Agreement) or any other Related Document related to the payment of principal or interest on the Series 1 Notes, Bank Note or Loans or the pledge of and Lien on the Bond and Note Revenues (as defined in the Credit Agreement) or the Collateral (as defined in the Credit Agreement) shall at any time for any reason cease to be valid and binding or fully enforceable on the Department or shall be declared to be null and void, invalid or unenforceable as determined by any Governmental Authority of competent jurisdiction in a final nonappealable judgment or as a result of any legislative or administrative action by any Governmental Authority having jurisdiction over the Department, or (ii)(a) the validity or enforceability of any provision of applicable law or the Credit Agreement, the Series 1 Notes, the Bank Note, the Issuing and Paying Agent Agreement, the Resolution or any other Related Document related to the payment of principal or interest on Series 1 Notes, the Bank Note or Loans or the pledge of and Lien on the Bond and Note Revenues or the Collateral shall be publicly repudiated or repudiated in writing or publicly contested or contested in writing by the Department or (b) any Governmental Authority having appropriate jurisdiction over the Department shall make a finding or ruling or shall enact or adopt legislation or issue an executive order or enter a judgment or decree which contests the validity or enforceability of any material provision of the Credit Agreement, the Series 1 Notes, the Bank Note, the Issuing and Paying Agent Agreement, the Resolution or any other Related Document related to the payment of principal or interest on the Series 1 Notes, Bank Note or Loans or the pledge of and Lien on the Bond and Note Revenues

or the Collateral, or (c) the Department shall publicly deny or deny in writing that it has any or further liability or obligation under the Credit Agreement, Series 1 Notes, the Bank Note, the Issuing and Paying Agent Agreement, the Resolution or any other Related Document (other than the Fee Agreement, the Offering Memorandum, the Dealer Agreement or any exhibit or schedule to any of the Related Documents), or (iii) any material provision of the Credit Agreement, Series 1 Notes, the Bank Note, the Issuing and Paying Agent Agreement, the Resolution or any other Related Document other than a provision described in clause (i) and (ii) of this paragraph (h) shall at any time for any reason cease to be valid and binding on the Department, or shall be declared in a final nonappealable judgment by any court having jurisdiction over the Department to be null and void, invalid, or unenforceable, or the validity or enforceability thereof shall be denied or contested by the Department;

(i) (i) the Department shall impose, declare or announce (whether or not in writing) a debt moratorium, debt restructuring, debt adjustment or comparable extraordinary restriction on the repayment when due and payable of the principal of or interest on any Specified Debt (including, without limitation, the Series 1 Notes, the Bank Note or the Loans) or any Parity Debt or (ii) any Governmental Authority having appropriate jurisdiction over the Department shall impose, declare or announce (whether or not in writing) as a result of a finding, ruling or other determination or shall enact or adopt legislation or issue an executive order or enter a judgment or decree which results in a debt moratorium, debt restructuring, debt adjustment or comparable extraordinary restriction on the repayment when due and payable of the principal of or interest on the Series 1 Notes, the Loans or Bank Note or on all Parity Debt;

(j) (i) the long term unenhanced rating by any of Fitch, Moody's or S&P (each as defined in the Credit Agreement) (in each case to the extent such Rating Agency (as defined in the Credit Agreement) is then providing a rating) on any long term unenhanced Senior Lien Obligations shall be withdrawn or suspended (for credit related reasons) or reduced below "A2" (or its equivalent), "A" (or its equivalent) or "A" (or its equivalent) respectively, or (ii) (x) the long term unenhanced rating by Fitch, Moody's and S&P (in each case to the extent such Rating Agency is then providing a rating) on any Senior Lien Obligations shall be withdrawn or suspended (for credit related reasons) or reduced below "Baa3" (or its equivalent), "BBB-" (or its equivalent) and "BBB-" (or its equivalent), respectively or (y) if at any time the Rating Agencies provide a long term unenhanced rating on any Parity Debt (including, without limitation, the Series 1 Notes), such long term unenhanced rating is withdrawn or suspended (for credit related reasons) or reduced by Fitch, Moody's and S&P (in each case to the extent such Rating Agency is then providing a rating) below "Baa3" (or its equivalent), "BBB-" (or its equivalent) and "BBB" (or its equivalent), respectively;

(k) an "Event of Default" as defined in the Resolution or the Issuing and Paying Agent Agreement shall occur and be continuing or the Department shall default in the due performance or observance of any material term, covenant or agreement contained in any other Related Document and the same shall not have been cured within any applicable cure period;

(l) (A) (i) the Department or any Governmental Authority shall impose, declare or announce (whether or not in writing) a debt moratorium, debt restructuring, debt adjustment or comparable extraordinary restriction on the repayment when due and payable of the principal of or interest on any indebtedness of the Department other than as set forth in paragraph (i) under the heading "Events of Default" above; or (ii) there shall be appointed or designated with respect to the Department an entity such as an organization, board, commission, authority, agency or body to monitor or declare a financial emergency or similar state of financial distress with respect to the Department, or there shall be declared by the Department or by any legislative or regulatory body with competent jurisdiction over the Department, the existence of a state of financial emergency or similar state of financial distress in respect of the Department; or (B) the Department shall not pay, or be unable to pay, its debts generally as they become due; or

(m) dissolution or termination of the existence of the Department.

Remedies

Upon the occurrence of any Event of Default, other than an Event of Default specified in paragraph (g) under the heading “Events of Default” above, the Bank may declare the Bank Note and the Loans, all accrued interest thereon, and all other amounts payable under the Credit Agreement to be forthwith due and payable, whereupon the Bank Note and the Loans and such interest and all such amounts shall become and be forthwith due and payable without presentment, demand, protest or further notice of any kind, all of which are thereby expressly waived by the Department. If any Event of Default specified in paragraph (g) under the heading “Events of Default” above shall occur, without any notice to the Department or any other act by the Bank, the Bank Note and the Loans, together with accrued interest thereon, and all other amounts payable under the Credit Agreement, shall become forthwith due and payable, without presentment, demand, protest, or other notice of any kind, all of which are thereby waived by the Department.

Upon the occurrence of any Event of Default described in clause (i) of paragraph (a), clause (i) of paragraph (e), subclause (A) of clause (i) of paragraph (f), paragraph (g), clause (i) of paragraph (h), paragraph (i), clause (ii) of paragraph (j) or paragraph (m) under the heading “Events of Default” above (each a “*Special Event of Default*”), (i) the Commitment shall automatically and immediately terminate with respect to all Series 1 Notes and the Bank shall have no obligation to make any Loan or to fund any outstanding Series 1 Note, and (ii) the Bank shall use commercially reasonable efforts to deliver a Notice of Termination (as defined in the Credit Agreement) to the Issuing and Paying Agent and the Dealer; *provided, however*, that the failure to do so shall in no way affect the automatic and immediate termination of the Commitment under the Credit Agreement.

Upon the occurrence of an Event of Default that is not a Special Event of Default, the Bank may, by notice to the Department, terminate the Commitment, if any (except as provided below), deliver a Notice of No Issuance (as defined in the Credit Agreement) to the Department and Issuing and Paying Agent directing the Issuing and Paying Agent to cease issuing all Series 1 Notes, whereupon no additional Series 1 Notes shall be issued, the Available Principal Commitment (as defined in the Credit Agreement) shall immediately be reduced to the then outstanding principal amount of Series 1 Notes and the Available Interest Commitment (as defined in the Credit Agreement) shall immediately be reduced to the amount of interest to accrue on such outstanding Series 1 Notes, and the Available Commitment shall be further reduced in a similar manner as and when such Series 1 Notes mature; *provided* that the Commitment shall not terminate, and the right of the Bank to accelerate the maturity of the Bank Note and the Loans shall not effect the obligation of the Bank to make Loans in an aggregate principal amount equal to the Commitment to the extent necessary for the Department to make required payments of principal on the Series 1 Notes issued and sold prior to the date upon which the Notice of No Issuance is received by the Issuing and Paying Agent; *provided further* that if any Loans are made that would not have been made but for the application of the immediately preceding provision, such Loans shall be immediately due and payable on the date such Loans are made.

Upon the occurrence of an Event of Default under clause (ii) of paragraph (h) under the caption “Events of Default” above, the obligation of the Bank to make Loans under the Credit Agreement shall be suspended from the time of the occurrence of such Event of Default until a final, non appealable judgment of a court having jurisdiction in the premises shall be entered declaring that all contested provisions of the Credit Agreement, the Series 1 Notes, the Bank Note, the Issuing and Paying Agent Agreement, the Resolution or any other Related Document relating to the payment of principal or interest on the Series 1 Notes, the Bank Note or any Loans or the validity or enforceability of the pledge of and lien on the Collateral are upheld in their entirety. In the event a judgment is entered declaring that all material contested provisions the Credit Agreement, the Series 1 Notes, the Bank Note, the Issuing and Paying Agent Agreement, the Resolution and any other Related Document relating to the payment of principal or interest on the Series 1 Notes, the Bank Note or any Loans or the validity or enforceability of the pledge of and lien on the Collateral are upheld in their entirety, the obligation of the Bank to make Loans under the Credit Agreement shall be automatically reinstated and the terms of the Credit Agreement will continue in full force and effect (unless the Credit Agreement shall have otherwise expired or terminated in

accordance with the terms thereof or there has occurred a Special Event of Default) as if there had been no suspension. In the event any provision of the Credit Agreement, the Series 1 Notes, the Bank Note, the Issuing and Paying Agent Agreement, the Resolution or any other Related Document relating to the payment of principal or interest on the Series 1 Notes, the Bank Note or any Loans or the validity or enforceability of the pledge of and lien on the Collateral is declared to be null and void or unenforceable, or it is determined that the Department has no liability or obligation under the Credit Agreement, the Series 1 Notes, the Bank Note, the Issuing and Paying Agent Agreement, the Resolution or any other Related Document, then the obligations of the Bank under the Credit Agreement will terminate as set forth therein. Notwithstanding the foregoing, if, upon the date which is the earlier of the Commitment Termination Date (as defined in the Credit Agreement) or one (1) year after the effective date of such suspension of the obligation of the Bank pursuant to this paragraph, litigation is still pending and a judgment regarding the validity and enforceability the Credit Agreement, the Series 1 Notes, the Bank Note, the Issuing and Paying Agent Agreement, the Resolution or any other Related Document relating to the payment of principal or interest on the Series 1 Notes, the Bank Note or any Loans or the validity or enforceability of the pledge of and lien on the Collateral as is the subject of such Event of Default has not been obtained, then the Commitment and the obligation of the Bank to make Loans thereunder shall at such time terminate without notice or demand.

Upon the occurrence of a Default described under clause (ii) of paragraph (g) or clause (iii) of paragraph (g) under the caption “Events of Default” above, the obligation of the Bank to make Loans under the Credit Agreement shall be suspended until the proceeding referred to therein is terminated prior to the court entering an order granting the relief sought in such proceeding. In the event such proceeding is terminated, the obligation of the Bank to make Loans under the Credit Agreement shall be reinstated and the terms of the Credit Agreement will continue in full force and effect (unless the obligation of the Bank to make Loans hereunder shall have otherwise expired or terminated in accordance with the terms thereof or there has occurred a Special Event of Default) as if there had been no such suspension.

Failure to take action in regard to one or more Events of Default shall not constitute a waiver of, or the right to take action in the future in regard to, such or subsequent Events of Default.

CERTAIN INFORMATION CONCERNING THE BANK

The liquidity provider for the Series 1 Notes is Bank of America, N.A. (referred to herein as the “Bank”).

Bank of America, N.A. (the “Bank”) is a national banking association organized under the laws of the United States, with its principal executive offices located in Charlotte, North Carolina. The Bank is a wholly-owned indirect subsidiary of Bank of America Corporation (the “Corporation”) and is engaged in a general consumer banking, commercial banking and trust business, offering a wide range of commercial, corporate, international, financial market, retail and fiduciary banking services. As of December 31, 2016, the Bank had consolidated assets of \$1.68 trillion, consolidated deposits of \$1.334 trillion and stockholder’s equity of \$206.21 billion based on regulatory accounting principles.

The Corporation is a bank holding company and a financial holding company, with its principal executive offices located in Charlotte, North Carolina. Additional information regarding the Corporation is set forth in its Annual Report on Form 10-K for the fiscal year ended December 31, 2016, together with its subsequent periodic and current reports filed with the Securities and Exchange Commission (the “SEC”).

Filings can be inspected and copied at the public reference facilities maintained by the SEC at 100 F Street, N.E., Washington, D.C. 20549, United States, at prescribed rates. In addition, the SEC maintains a website at <http://www.sec.gov> which contains reports, proxy statements and other information regarding registrants that file such information electronically with the SEC.

The information concerning the Corporation and the Bank is furnished solely to provide limited introductory information and does not purport to be comprehensive. Such information is qualified in its entirety by the detailed information appearing in the referenced documents and financial statements referenced therein.

The Bank will provide copies of the most recent Bank of America Corporation Annual Report on Form 10-K, any subsequent reports on Form 10-Q, and any required reports on Form 8-K (in each case as filed with the SEC pursuant to the Exchange Act), and the publicly available portions of the most recent quarterly Call Report of the Bank delivered to the Comptroller of the Currency, without charge, to each person to whom this document is delivered, on the written request of such person. Written requests should be directed to:

Bank of America Corporate Communications
100 North Tryon St, 18th Floor
Charlotte, North Carolina 28255
Attention: Corporate Communication

PAYMENTS OF PRINCIPAL AND INTEREST ON THE NOTES WILL BE MADE AT MATURITY FROM MONEYS RECEIVED BY THE ISSUING AND PAYING AGENT FROM OR ON BEHALF OF THE DEPARTMENT; PROVIDED, HOWEVER, TO THE EXTENT SUCH MONIES ARE INSUFFICIENT SHALL BE PAID FROM ADVANCES MADE BY THE BANK TO THE ISSUING AND PAYING AGENT UNDER THE CREDIT AGREEMENT. ALTHOUGH THE OBLIGATION OF THE BANK TO FUND ADVANCES IS A BINDING OBLIGATION OF THE BANK, THE NOTES ARE NOT DEPOSITS OR OBLIGATIONS OF THE CORPORATION OR ANY OF ITS AFFILIATED BANKS AND ARE NOT GUARANTEED BY ANY OF THESE ENTITIES. THE NOTES ARE NOT INSURED BY THE FEDERAL DEPOSIT INSURANCE CORPORATION OR ANY OTHER GOVERNMENTAL AGENCY AND ARE SUBJECT TO CERTAIN INVESTMENT RISKS, INCLUDING POSSIBLE LOSS OF THE PRINCIPAL AMOUNT INVESTED.

The delivery of this information shall not create any implication that there has been no change in the affairs of the Corporation or the Bank since the date of the most recent filings referenced herein, or that the information contained or referred to under this heading “CERTAIN INFORMATION CONCERNING THE BANK” is correct as of any time subsequent to the referenced date.

The information set forth under this heading “CERTAIN INFORMATION CONCERNING THE BANK” has been furnished by the Bank and no representation is made by the Department or the Dealers as to the accuracy or completeness of such information. The Bank has no responsibility for the form and content of this Offering Memorandum, other than solely with respect to the information describing the Bank set forth under this heading “CERTAIN INFORMATION CONCERNING THE BANK” and has not independently verified, makes no representation regarding, and does not accept any responsibility for the accuracy or completeness of this Offering Memorandum or any information or disclosure contained herein, other than solely with respect to the information describing the Bank set forth under this heading “CERTAIN INFORMATION CONCERNING THE BANK”, or omitted herefrom.

LITIGATION

No litigation is pending or threatened concerning the validity or enforceability of the Series 1 Notes or the Water Supply Contracts, except as described above under the heading “The Water Supply Contracts – Monterey Amendment Litigation.”

At any given time, including the present, there are a number of civil actions pending against the Department, which could, if determined adversely to the Department, affect the Department’s expenditures and in some cases, its revenues. However, the Department does not believe there are any pending actions that are likely

to have a material adverse effect on the Department's ability to pay principal of and interest on the Series 1 Notes when due.

TAX MATTERS

In the opinion of Orrick, Herrington & Sutcliffe LLP, Note Counsel to the Department, based on an analysis of existing laws, regulations, rulings and court decisions, and assuming, among other matters, the accuracy of certain representations and compliance with certain covenants, interest on the Series 1 Notes when the Series 1 Notes are issued in accordance with the Resolution and the Tax Certificate, will be excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986 (the "Code") and is exempt from State of California personal income taxes. The amount treated as interest on the Tax-Exempt Notes and excluded from gross income will depend upon the taxpayer's election under Internal Revenue Service Notice 94-84. Note Counsel is of the further opinion that interest on the Series 1 Notes is not a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although Note Counsel observes that interest on the Series 1 Notes is included in adjusted current earnings when calculating corporate alternate minimum taxable income. Note Counsel expresses no opinion regarding any other tax consequences related to the ownership or disposition of, or the amount, accrual or receipt of interest on, the Series 1 Notes. A complete copy of the proposed form of opinion of Note Counsel is set forth in Appendix B. Note Counsel does not intend to take any action to update such opinion after the date of its delivery to the Department (expected to be May 4, 2017) or to determine if interest on the Series 1 Notes is thereafter excluded from gross income for federal income tax purposes.

The Code imposes various restrictions, conditions and requirements relating to the exclusion from gross income for federal income tax purposes of interest on obligations such as the Series 1 Notes. The Department has made certain representations and covenanted to comply with certain restrictions, conditions and requirements designed to ensure that interest on the Series 1 Notes will not be included in federal gross income. Inaccuracy of these representations or failure to comply with these covenants may result in interest on the Series 1 Notes being included in federal gross income, possibly from the date of issuance of the Series 1 Notes. The opinion of Note Counsel assumes the accuracy of these representations and compliance with such covenants. Note Counsel has not undertaken to determine (or to inform any person) whether any action taken (or not taken) or events occurring (or not occurring) or any other matters coming to Note Counsel's attention after the delivery of its Note Counsel opinion referenced above may adversely affect the value of, or the tax status of interest on, the Series 1 Notes. Accordingly, the opinion of Note Counsel is not intended to, and may not, be relied upon in connection with any such actions, events or matters.

Although Note Counsel is of the opinion that interest on the Series 1 Notes is excluded from gross income for federal income tax purposes and is exempt from State of California personal income taxes, the ownership or disposition of, or the amount, accrual or receipt of interest on, the Series 1 Notes may otherwise affect the beneficial owner's federal, state or local tax liability. The nature and extent of these other tax consequences depends upon the particular tax status of the beneficial owner or the beneficial owner's other items of income or deduction. Note Counsel expresses no opinion regarding any such other tax consequences.

Current and future legislative proposals, if enacted into law, clarification of the Code or court decisions may cause interest on the Series 1 Notes to be subject, directly or indirectly, to federal income taxation or to be subject to or exempted from state income taxation, or otherwise prevent beneficial owners from realizing the full current benefit of the tax status of such interest. For example, presidential budget proposals in previous years have proposed legislation that would limit the exclusion from gross income of interest on the Series 1 Notes to some extent for high-income individuals. The introduction or enactment of any such legislative proposals, clarification of the Code or court decisions may also affect the market price for, or marketability of, the Series 1 Notes. Prospective purchasers of the Series 1 Notes should consult their own tax advisors regarding any

pending or proposed federal or state tax legislation, regulations or litigation, as to which Note Counsel expresses no opinion.

The opinion of Note Counsel is based on current legal authority, covers certain matters not directly addressed by such authorities, and represents Note Counsel's judgment as to the proper treatment of the Series 1 Notes for federal income tax purposes. It is not binding on the Internal Revenue Service ("IRS") or the courts. Furthermore, Note Counsel cannot give and has not given any opinion or assurance about the future activities of the Department, or about the effect of future changes in the Code, the applicable regulations, the interpretation thereof or the enforcement thereof by the IRS. The Department has covenanted, however, to comply with the requirements of the Code.

Unless separately engaged, Note Counsel is not obligated to defend the Department or the beneficial owners regarding the tax-exempt status of the Series 1 Notes in the event of an audit examination by the IRS. Under current procedures, parties other than the Department and their appointed counsel, including the beneficial owners, would have little, if any, right to participate in the audit examination process. Moreover, because achieving judicial review in connection with an audit examination of tax-exempt notes is difficult, obtaining an independent review of IRS positions with which the Department legitimately disagrees may not be practicable. Any action of the IRS, including but not limited to selection of the Series 1 Notes for audit, or the course or result of such audit, or an audit of bonds presenting similar tax issues may affect the market price for, or the marketability of, the Series 1 Notes, and may cause the Department or the beneficial owners to incur significant expense.

FINANCIAL STATEMENTS

The financial statements of the State Water Resources Development System at June 30, 2016, and June 30, 2015, and for the years then ended, appearing in Appendix A to this Offering Memorandum have been audited by Gallina LLP, independent auditors, as set forth in the report of Gallina LLP, appearing in Appendix A.

The State Water Resources Development System includes the State Water Project, the Davis-Grunsky Act Program and the San Joaquin Drainage Program.

APPROVAL OF LEGAL PROCEEDINGS

The issuance of the Series 1 Notes is subject to the approving opinion of Orrick, Herrington & Sutcliffe LLP, Note Counsel. A copy of the proposed form of such opinion is set forth in Appendix B to this Offering Memorandum. The opinion is subject to the additional matters described herein under the caption "Tax Matters."

CERTAIN RELATIONSHIPS

The Dealers and their respective affiliates comprise full service financial institutions engaged in various activities, which may include securities trading, commercial and investment banking, financial advisory, investment management, principal investment, hedging, financing and brokerage activities. In the ordinary course of their respective businesses, the Dealers and certain of their respective affiliates have engaged, are engaged, and may in the future engage, in investment banking and/or commercial banking transactions and/or advisory services with the Department. The Dealers and their respective affiliates may have, from time to time, performed and may in the future perform, various investment banking services for the Department for which they received or will receive customary fees and expenses. In the ordinary course of their various business activities, the Dealers and their respective affiliates may make or hold a broad array of investments and actively trade debt and equity securities (or related derivative securities and financial instruments which may include bank loans and/or credit default swaps) for their own accounts and for the accounts of their customers and may at any time hold long and

short positions in such securities and instruments. Such investment securities activities may involve securities and instruments of the Department.

No Dealer is acting as a financial advisor or a municipal advisor (as such term is defined in Section 975(e) of the Dodd-Frank Wall Street Reform and Consumer Protection Act) to the State in connection with the issuance, offering or sale from time to time of the Series 1 Notes.

ADDITIONAL INFORMATION AND CONTINUING DISCLOSURE

The Series 1 Notes are exempt from Rule 15c2-12 of the Securities and Exchange Commission relating to continuing disclosure of annual financial information and certain material events and, accordingly, the Department is not required to file reports with the Securities and Exchange Commission in connection with the Series 1 Notes. The Department will make available, upon request, copies of its most recent Audited Financial Statements, Official Statement relating to its Water System Revenue Bonds, the Credit Agreement and the Resolution. Requests for any of the foregoing should be directed to:

State of California
Department of Water Resources
1416 Ninth Street, Room 805
Sacramento, CA 95814
Attention: Chief, Division of Fiscal Services

In addition, the Department has covenanted for the benefit of the holders and beneficial owners of certain of its Water System Revenue Bonds to provide certain financial information and operating data relating to the Department by not later than 270 days following the end of the Department's fiscal year (which fiscal year as of the date hereof ends June 30) (the "Annual Report") and to provide notices of the occurrence of certain enumerated events. Unless otherwise directed by the Municipal Securities Rulemaking Board ("MSRB") or the Securities and Exchange Commission, the Annual Report and notices of such enumerated events will be filed by the Department with the MSRB through its Electronic Municipal Market Access website.

APPENDIX A

**FINANCIAL STATEMENTS OF THE
STATE WATER RESOURCES DEVELOPMENT SYSTEM**

State Water Resources Development System

An Enterprise Fund of the State of California



State Water Resources Development System

An Enterprise Fund of the State of California

Comprehensive Annual Financial Report
For the years ended June 30, 2016 and 2015

STATE OF CALIFORNIA
Edmund G. Brown Jr., Governor

NATURAL RESOURCES AGENCY
John Laird, Secretary for Natural Resources

DEPARTMENT OF WATER RESOURCES
Mark W. Cowin, Director

Mark Anderson
Acting Deputy Director

Carl Torgersen
Chief Deputy Director

Kathie Kishaba
Deputy Director

John Pacheco
Acting Deputy Director

Cindy Messer
Assistant Chief Deputy Director

William Croyle
Deputy Director

Taryn Ravazzini
Deputy Director

Spencer Kenner
Chief Counsel

Gary Bardini
Deputy Director

Division of Fiscal Services
Perla M. Netto-Brown, Chief

This document was prepared under the direction of the Enterprise Branch of the Department's Fiscal Services Division:

Lisa Toms.....Accounting Administrator III

Enterprise Accounting Branch

Alicia Ramirez.....Accounting Administrator II
Rachel Corbett.....Accounting Administrator II
Lori Lay.....Accounting Administrator I
Antonio Perez.....Accounting Administrator I
Jeanet Uy.....Accounting Administrator I
Ted Lambert.....Accounting Administrator I
Eleanor De Anda.....Accounting Administrator I
Tina Nguyen.....Accounting Administrator I
Omid Torabian.....Accounting Administrator I
Thu Nguyen.....Associate Accounting Analyst
Bess Leung.....Associate Accounting Analyst
Jesus Parrilla.....Associate Accounting Analyst
Theresa Lee.....Associate Accounting Analyst
Sharon Chu.....Associate Accounting Analyst
Carla Elder.....Associate Accounting Analyst
Jesse Gonzalez-Perez.....Senior Accounting Officer
Nakithia Thomas.....Senior Accounting Officer
Martha Romaso.....Senior Accounting Officer
Alex Caputo.....Accounting Officer
Juana Hernandez.....Accountant Trainee
Ilesha Williams.....Executive Secretary
Kevin Lim.....Office Technician

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INTRODUCTORY SECTION





December 5, 2016

To the Citizens of the State of California:

We are pleased to present the Comprehensive Annual Financial Report (CAFR) of the State Water Resources Development System (“the System”) for the fiscal years ended June 30, 2016 and 2015, along with the Independent Auditors’ Report. The CAFR has been prepared by the California Department of Water Resources (DWR) in conformance with the principles and standards for financial reporting set forth by the Governmental Accounting Standards Board (GASB). Responsibility for both the accuracy of the data and the completeness and fairness of the presentation, including all disclosures, rests with the DWR. We believe that the data, as presented, is accurate in all material respects; that its presentation fairly shows the financial position and the results of the System’s operations as measured by the financial activity of its various funds; and that the included disclosures will provide the reader with an understanding of the System’s financial affairs.

This CAFR was prepared using the financial reporting requirements as prescribed by the GASB Statement No. 34, *Basic Financial Statements - and Management’s Discussion and Analysis - for State and Local Governments* (GASB 34). This GASB Statement requires that management provide a narrative introduction, overview, and analysis to accompany the Basic Financial Statements in the form of a Management’s Discussion & Analysis (MD&A). This letter of transmittal is designed to complement the MD&A and should be read in conjunction with it. The MD&A can be found immediately following the report of the independent auditors.

THE REPORTING ENTITY AND ITS SERVICES

Reporting Entity

The System operates as an Enterprise fund administered by the California Department of Water Resources (DWR)¹. The DWR operates within the Natural Resources Agency of the State of California, and is responsible for the planning, construction, and operation of the System. DWR was established in 1956 by an act of the State Legislature that combined the functions of the Water Project Authority and certain responsibilities of the Department of Public Works' former Division of Water Resources. At present, DWR employs 3,294 full-time staff throughout the State, of which approximately 2,400 are allocated to the System.

The System includes the State Water Project (SWP), the Davis-Grunsky Act Program, and the San Joaquin Drainage Implementation Program.

DWR's operations, with respect to the SWP, are accounted for and conducted under Segments² consisting of special funds established by the California Water Code. These Segments are (a) the State Water Resources Development Bond Fund (Bond Fund), which was formed when the voters of the State of California passed the Burns-Porter Act in 1960; and (b) the Central Valley Project Construction Fund (Construction Fund) and the Central Valley Project Revenue Fund (Revenue Fund), which were enabled under California's Central Valley Project Act of 1933.

DWR's operations, with respect to the System, are separate and apart from DWR's operations that are primarily funded by State General Fund appropriations and from DWR's Power Supply Program.

Services

The System encompasses dams, reservoirs, pumping plants, power plants, aqueducts, and pipelines owned³ and operated by the State of California. The System was developed in order to deliver water to areas of need, throughout the State, for domestic, industrial, and agricultural purposes, as well as to provide flood control, recreation, fish and wildlife enhancement, hydroelectric power, and other benefits. DWR is responsible for the planning, construction, and operation of the System. All 647 miles of the initially planned aqueduct system have been completed. The 444-mile main stem of the California Aqueduct runs from a point near Stockton southward to a terminus in Riverside County. The dependable annual water supply available for delivery by the existing System varies yearly depending on hydrologic conditions and regulatory mandates.

Joint-Use Facilities

Portions of the System consist of facilities developed and used jointly with the Federal Central Valley Water Project (FCVP) operated by the U.S. Bureau of Reclamation (USBR). In addition, both projects have primary sources of water north of the Sacramento-San Joaquin Delta (Delta), transport water across the Delta and draw water from the southern edge of the Delta. The FCVP, like the System, provides water for irrigation in the Central Valley, urban water supply, water quality, flood control, power, recreation, and fish and wildlife enhancement. Capital costs,

¹ See the accompanying MD&A for more on Enterprise Funds

² See the accompanying MD&A for more on the System's Segments

³ Certain assets are owned jointly by the State and the United States Bureau of Reclamation. See *Joint-Use Facilities*

for the jointly developed facilities, are shared approximately 55 percent State and 45 percent Federal.

In 1986, the System and USBR entered into a Coordinated Operation Agreement (COA) under which the System and the FCVP coordinate operations, including releases from upstream reservoirs and pumping from the Delta. The COA permits increases operational efficiency of both projects, ensures that each project receives an equitable share of available surplus water and provides for sharing of responsibilities in meeting certain Delta water quality standards.

The Water Supply Contracts

DWR has entered into Water Supply Contracts with 29 local public agencies (Water Contractors), which provide for DWR to recover substantially all System costs. The Water Contractors are principally located in the San Francisco Bay Area, the Central Coast, the Central Valley, and Southern California, and their service areas encompass approximately 25 percent of the State's land area and approximately 69 percent of its population.

Payments by the Water Contractors under the Water Supply Contracts provide for the operation, maintenance, planning, and capital costs, including interest, of the SWP. The Water Contractors may request up to a maximum annual aggregate amount totaling 4,172,786 acre-feet of water from the System. This maximum does not assure delivery of that amount of water, but rather provides the basis for proportional allocation of available supplies and certain costs among the Water Contractors.

Generally, the existing Water Supply Contracts are to remain in effect until 2035 or until all bonds issued to finance construction costs of SWP facilities have been repaid (currently 2029), whichever period is longer. Under its Water Supply Contract, each Water Contractor may request water deliveries from the SWP up to a maximum specified annual amount, and agrees to pay its allocated share of the costs of gathering, storing, conveying, and delivering water. Generally, DWR's costs of providing the facilities of the SWP, including interest, are payable by the Water Contractors whether or not water is delivered. If a Water Contractor defaults under their Water Supply Contract, DWR may, upon six months' notice, suspend water deliveries to that Water Contractor. During such period, the Water Contractor remains obligated to make all payments required by the Water Supply Contract. If a Water Contractor fails or is unable to raise sufficient funds, by other means, to make Contract payments, the Water Contractor is required, by the Contract, to levy a tax or assessment sufficient for such purpose.

DWR and the affected Water Contractors have entered into an Off-Aqueduct Power Facilities Amendment, East Branch Enlargement Amendment, Water System Revenue Bond Amendment, Coastal Branch Extension Amendment, East Branch Extension Amendment, and a South Bay Aqueduct Enlargement Amendment to the Water Supply Contracts for the purpose of financing certain Water System Projects. These Amendments established procedures to provide for the payment of construction costs financed with Revenue Bonds by establishing separate subcategories of charges to produce the revenues required to pay all of the annual financing costs, including coverage, of the Bonds allocable to such Amendment Projects. If any Water Contractor defaults on payment under any of these Amendments, other than the Coastal Branch Extension Amendment, East Branch Extension Amendment, and the South Bay

Aqueduct Enlargement Amendment, the shortfall may be collected from non-defaulting affected Water Contractors, subject to certain limitations.

In December 1994, representatives of DWR and certain Water Contractors adopted a set of principles pursuant to which additional amendments to the Water Supply Contracts have since been negotiated. This amendment is known as the “Monterey Amendment.”

ECONOMIC OUTLOOK

The System recovers the majority of its construction and operating costs from the Water Contractors, who are obligated to pay for such costs whether or not water deliveries are made. If a Water Contractor fails or is unable to raise sufficient funds by other means to make Water Supply Contract payments, the Contractor is required, by the Contract, to levy a tax or assessment sufficient for such purpose. With such protections, the financial viability of the System remains strong even in times of drought or other significant events.

MAJOR INITIATIVES AND ACHIEVEMENTS

Water Supply Contract Extension

In May 2013, DWR and the Water Contractors began negotiations in a public forum to develop contract amendments to extend the term and change certain financial provisions of the Water Supply Contracts. In June 2014, the negotiators for DWR and the Water Contractors reached a general agreement on principles for such an amendment. DWR and 25 of the 29 Contractors have signed the Agreement in Principle (AIP). The County of Butte, Plumas County Flood Control and Water Conservation District, San Luis Obispo Flood Control and Water Conservation District, and the Santa Barbara Flood Control and Water Conservation District have not signed the AIP.

Currently, subject to individual elections for continued service by each Water Contractor, the Water Supply Contracts are to remain in effect for the longest of 75 years, December 31, 2035, or until all bonds issued to finance construction costs of SWP facilities have been repaid, whichever period is longest. No Bonds have been sold with a maturity date later than December 1, 2035. The 75-year term provision currently results in the Water Supply Contracts having varying termination dates that range between December 31, 2035 and 2042, subject to the aforementioned election. For each Water Contractor that signs an amendment under the AIP, the term of the Water Supply Contract would be extended until December 31, 2085.

Also under the AIP, certain provisions that provide for charges to the Water Contractors for capital costs and certain other costs, currently made on an amortized basis, would be amended to provide for charges to the Contractors on an annual “pay-as-you-go” basis to provide the revenues needed by DWR to make debt service payments each year. The current provisions authorizing DWR to charge the Water Contractors annually for the full amount of the required annual debt service and coverage on the Bonds will continue in any extended contract. Other provisions addressed in the AIP would provide for, among other things, an increase in DWR’s operating reserves; a mechanism for financing capital projects, using System funds, and recovering those costs with interest from the Water Contractors; establishment of an account to

pay for certain System expenses not chargeable to the Water Contractors; and the establishment of a Finance Committee consisting of DWR and Water Contractor representatives to serve as a forum for discussions and to provide a channel for recommendations to the Director of DWR concerning financial policies of the System.

Environmental review pursuant to the California Environmental Quality Act (CEQA) and a presentation by DWR in an informational hearing to the Legislature will be part of the contract extension amendment process before any contract amendment is adopted. In August 2016, DWR released, for public comment, a draft Environmental Impact Report (EIR) for the proposed contract extension amendment. The public comment period on the draft EIR is scheduled to close on October 17, 2016. Any amendment that is ultimately adopted will comply with DWR's covenant in the General Bond Resolution not to agree to any amendment to the Water Supply Contracts, which would materially adversely affect the security for the Bonds.

Renewable Energy

The System plans to procure approximately 920 GW of renewable energy by 2025. Purchase agreements for such power include:

- An ongoing contract with Alameda Municipal Power, purchased under the counterparty Northern California Power Agency (NCPA), through December 31, 2016, for renewable geothermal and landfill gas energy bundled with Renewable Energy Credits.
- A 20-year contract with RE Camelot Solar Photovoltaic Project⁴ for the purchase of 45 MW of solar photovoltaic energy and associated capacity bundled with Renewable Energy Credits from their facility located in southeastern Kern County. The RE Camelot Plant is expected to deliver 125,000 MW of annual generation.
- A 20-year contract for 85 MW from Solverde 1, LLC whose facility, built near Lancaster in northern Los Angeles County, is expected to be operational by late December 2016 and from which the System will receive approximately 230,000 MW of annual generation.
- A 20-year contract for 9.5 MW with Sun Power Corporation, Systems for a facility built at the Pearblossom power plant. This Pearblossom facility is expected to be operational by December 2016 and includes an additional 10-year option to extend, and a forecasted annual generation of approximately 28,000 MW.

OTHER FINANCIAL INFORMATION

Internal Controls

In developing and evaluating the System's accounting system, consideration is given to the adequacy of internal accounting controls. Internal accounting controls are designed to provide reasonable, but not absolute, assurance regarding the safeguarding of assets against loss from unauthorized use or disposition, and the reliability of financial records for preparing financial statements and maintaining accountability for assets. The concept of reasonable assurance recognizes that the cost of a control should not exceed the benefits likely to be derived, and the evaluation of costs and benefits requires estimates and judgments by management. We believe

⁴ Owned and operated by Dominion Solar Holdings, Inc.

that the System's internal accounting controls adequately safeguard assets and provide reasonable assurance of proper recording of financial transactions.

Pension Fund Operations

The net pension liability represents the System's share of DWR's portion of the unfunded liability of the California Public Employees' Retirement System's (CalPERS) defined benefit plan.

INDEPENDENT AUDIT

The System requires an annual audit of its financial records. These records, represented in the CAFR, have been audited with an unqualified opinion by a certified public accounting firm, Gallina LLP. The Independent Auditors' Report on our current financial statements is presented in the Financial Section.

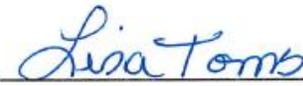
ACKNOWLEDGMENTS

We would like to express our appreciation to the entire staff of the Fiscal Services Division and the State Water Project Analysis Office, whose professionalism, dedication, and efficiency are responsible for the preparation of this report. We would also like to thank Gallina, LLP for their invaluable professional support in the preparation of the CAFR.

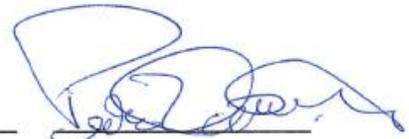
Respectfully submitted,



Alicia Ramirez
Accounting Admin II

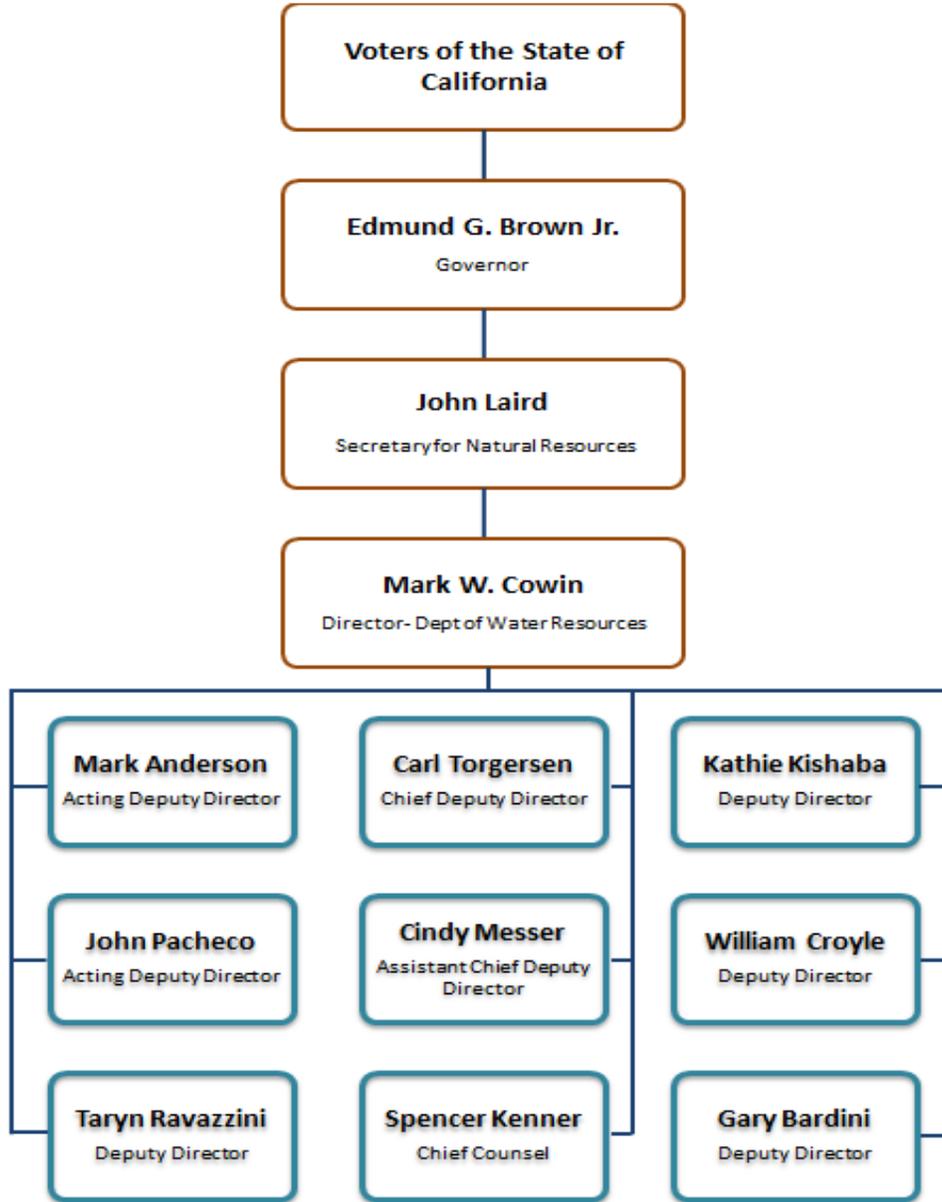


Lisa Toms
Accounting Admin III



Pedro Villalobos
Prin HEP Engineer

ORGANIZATION CHART





FINANCIAL SECTION



INDEPENDENT AUDITOR'S REPORT

To the Director of the State of California
Department of Water Resources

Report on the Financial Statements

We have audited the accompanying financial statements of the State Water Resources Development System (System), as of and for the years ended June 30, 2016 and 2015 and the related notes to the financial statements, which collectively comprise the System's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the System, as of June 30, 2016 and 2015, and the respective changes in its financial position and cash flows for the fiscal years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

As discussed in note 1, the financial statements present only the State Water Resources Development System, and do not purport to, and do not, present fairly the financial position of the State of California as of June 30, 2016 and 2015, the changes in its financial position, or 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 Matters

Required Supplementary Information

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

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the System's basic financial statements. The introductory section, statistical section and supplementary information are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The supplementary information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary information is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

The introductory and statistical sections have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on them.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated December 2, 2016, on our consideration of the System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the System's internal control over financial reporting and compliance.



Roseville, California
December 2, 2016

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

Management's Discussion and Analysis *(Required Supplementary Information)*

This discussion and analysis is designed to assist the reader in focusing on significant financial issues and activities and to identify any significant changes in the financial position of the State Water Resources Development System (System), which is administered by the California Department of Water Resources (DWR). Readers are encouraged to consider the information presented in conjunction with the financial statements as a whole, which follow Management's Discussion and Analysis. This discussion and analysis and the financial statements do not relate to DWR's other governmental and proprietary funds. The System includes the State Water Project (SWP), the Davis-Grunsky Act Program, and the San Joaquin Drainage Implementation Program.

Financial Highlights

- During fiscal 2016, the System recorded an increase in total assets of \$90.9 million on total operating revenues of \$1,087 million. However, this did not cause an increase in net position because of the deferral of timing differences in revenues collected and expenses incurred.
- Deferred inflows of resources for capital costs increased by \$90.7 million to an ending balance of \$774.2 million in fiscal 2016 compared to \$683.5 million in fiscal 2015. The increase is primarily due to net revenues collected for principal payments of previous costs incurred to construct Utility Plant in Service (UPIS) assets.
- On August 25, 2015, the System issued \$109.3 million of Water System Revenue Bonds (Series AU) to redeem \$104.6 million of Water Revenue Commercial Paper Notes Series 1. Series AU was issued as index floating rate bonds using the Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Index plus a spread to calculate monthly debt service payments. Series AU assumes a 2.07% variable rate for the life of the bonds.
- On May 24, 2016, the System issued Water System Revenue Bonds (Series AV) with a par amount of \$106.5 million and a \$22.2 million premium to redeem \$128.7 million of Water Revenue Commercial Paper Notes Series 1. Series AV was issued with fixed rates and an average yield of 1.84%.
- On June 24, 2016, the System defeased \$35.6 million of Water System Revenue Bonds relating to the System's Off-Aqueduct Projects, which included Reid Gardner Unit 4, Bottle Rock, and South Geysers. The System used proceeds from a settlement agreement received from the Nevada Power Company for the termination of participation in the Reid Gardner Unit 4 power-generating joint venture. The System deposited cash and certain investment securities in an irrevocable escrow with the Treasurer of the State of California, acting as Trustee and Escrow Agent.

- On December 1, 2015, the System paid off the Pooled Money Investment Account (PMIA) loan. The loan, which was scheduled to be fully paid and amortized in fiscal 2018, was paid off early from funds available in fiscal 2016. See Disclosure Note 6.

Overview of Financial Statements

This discussion and analysis is intended to serve as an introduction to the System's basic financial statements. The System's basic financial statements are comprised of three components: 1) Financial Statements, 2) Notes to the Financial Statements, and 3) Other Information.

Financial Statements

The System is accounted for as an enterprise fund. Enterprise funds account for the acquisition, operation and maintenance of governmental facilities and services that are entirely or predominantly self-supported by user charges. These financial statements report information using accounting methods similar (although not identical) to those used by private sector companies. The Statements of Net Position include all the assets, liabilities, deferred outflows and inflows of resources, and net position. The Statements of Revenues, Expenses and Changes in Net Position report all of the revenues and expenses incurred during the fiscal years presented. The Statements of Cash Flows report the cash inflows and outflows classified by operating, investing, noncapital financing, and capital and related financing activities during the reporting periods presented.

The Financial Statements can be found on pages 27 - 33 of this report.

Notes to the Financial Statements

The notes to the financial statements communicate certain information required by Generally Accepted Accounting Principles (GAAP). The notes to the financial statements can be found on pages 35 - 75 of this report.

Other Information

In addition to the basic financial statements and accompanying notes, this report also presents certain supplementary information concerning the System's adequacy of debt service coverage. Supplementary information can be found on pages 81 - 82 of this report.

Financial Analysis

The SWP is considered a regulated entity, as such rates are permitted to be set at levels intended to recover the estimated costs of providing regulated services or products, including the cost of capital. If revenues intended to cover some costs are provided before costs are incurred those revenues are reported as deferred inflows of resources and recognized as revenue when the associated costs are incurred. If regulation provides assurance that incurred costs will be recovered in the future, those costs are capitalized as receivables and recovered through future billings. As a result, net position does not change over time. The total net position of the System exceeded liabilities and deferred outflows at June 30, 2016 and 2015 by \$1,205.4 million each year.

Condensed Statements of Net Position

	2016	2015 (As restated)	2014	% Change 2016-2015	% Change 2015-2014
	(amounts in thousands)				
Other assets	\$ 2,268,741	\$ 2,344,435	\$ 2,035,702	-3.2%	15.2%
Total utility plant	<u>3,699,323</u>	<u>3,532,682</u>	<u>3,469,661</u>	4.7%	1.8%
Total assets	<u>5,968,064</u>	<u>5,877,117</u>	<u>5,505,363</u>	1.5%	6.8%
Total deferred outflows of resources	<u>230,231</u>	<u>219,326</u>	<u>116,741</u>	5.0%	87.9%
Total assets and deferred outflows of resources	<u>\$ 6,198,295</u>	<u>\$ 6,096,443</u>	<u>\$ 5,622,104</u>	1.7%	8.4%
Other liabilities	\$ 460,713	\$ 425,428	\$ 419,875	8.3%	1.3%
Long-term liabilities	<u>3,599,051</u>	<u>3,550,835</u>	<u>3,173,915</u>	1.4%	11.9%
Total liabilities	<u>4,059,764</u>	<u>3,976,263</u>	<u>3,593,790</u>	2.1%	10.6%
Total deferred inflows of resources	<u>933,103</u>	<u>914,752</u>	<u>822,886</u>	2.0%	11.2%
Net position:					
Net investment in capital assets	1,155,487	1,165,253	994,561	-0.8%	17.2%
Restricted	<u>49,941</u>	<u>40,175</u>	<u>210,867</u>	24.3%	-80.9%
Total net position	<u>1,205,428</u>	<u>1,205,428</u>	<u>1,205,428</u>	0.0%	0.0%
Total liabilities, deferred inflows of resources, and net position	<u>\$ 6,198,295</u>	<u>\$ 6,096,443</u>	<u>\$ 5,622,104</u>	1.7%	8.4%

* Certain amounts have been reclassified from amounts previously reported to conform with the current year presentation.

The largest portion of the System's current fiscal year net position is investments in capital assets, including but not limited to land, improvements, buildings, machinery, and equipment. Investments in capital assets are reflected net of accumulated depreciation less any outstanding related debt used to construct or acquire those assets. The main use of these capital assets is to provide water delivery and storage, flood control, recreation, fish and wildlife enhancement, and hydroelectric power. There was an increase in capital assets of \$166.6 million offset by a decrease of \$75.7 million primarily in amounts recoverable through future billings under the Water Supply Contracts, and an increase in debt and deferrals related to capital assets of \$100.7 million, causing an overall decrease in net investment in capital assets of \$9.8 million. Although the System's investments in its capital assets is reported net of related debt, it should be noted that resources needed to repay this debt must be provided from other sources, mainly contractual billings to the Water Contractors, since the capital assets themselves cannot be used to liquidate these liabilities.

The remaining balance of the System's current fiscal year net position represents restricted net position, which are resources subject to external restrictions on how they may be used. The System's restricted net position is for the support of the SWP, the Davis-Grunsky Act Program, and the San Joaquin Drainage Implementation Program.

The following table reflects how the System recognized revenues and expenses during the year:

Condensed Statements of Revenues, Expenses, and Changes in Net Position					
	2016	2015	2014	% Change 2016-2015	% Change 2015-2014
	(amounts in thousands)				
Operating revenues:					
Water supply	\$ 948,105	\$ 883,538	\$ 789,370	7.3%	11.9%
Power sales	71,236	91,780	131,952	-22.4%	-30.4%
Federal and State reimbursements	67,309	44,060	52,186	52.8%	-15.6%
Total operating revenues	<u>1,086,650</u>	<u>1,019,378</u>	<u>973,508</u>	<u>6.6%</u>	<u>4.7%</u>
Operating expenses:					
Operations and maintenance expense	511,926	404,627	557,209	26.5%	-27.4%
Purchased power expense	219,661	202,780	241,444	8.3%	-16.0%
Depreciation expense	77,170	81,495	68,896	-5.3%	18.3%
Operating expenses recovered, net	65,004	-	-	0.0%	0.0%
Total operating expenses	<u>873,761</u>	<u>688,902</u>	<u>867,549</u>	<u>26.8%</u>	<u>-20.6%</u>
Income from operations	212,889	330,476	105,959	-35.6%	211.9%
Capital revenues recovered (deferred), net	(118,510)	(243,945)	(42,934)	-51.4%	468.2%
Interest expense	(106,978)	(96,082)	(115,499)	11.3%	-16.8%
Other revenues (expenses), net	<u>12,599</u>	<u>9,551</u>	<u>52,474</u>	<u>31.9%</u>	<u>-81.8%</u>
Change in net position	-	-	-	-	-
Net position, beginning of year	1,205,428	1,205,428	1,205,428	0.0%	0.0%
Net position, end of year	<u>\$ 1,205,428</u>	<u>\$ 1,205,428</u>	<u>\$ 1,205,428</u>	<u>0.0%</u>	<u>0.0%</u>

* Certain amounts have been reclassified from amounts previously reported to conform with the current year presentation.

Revenues

Operating Revenues

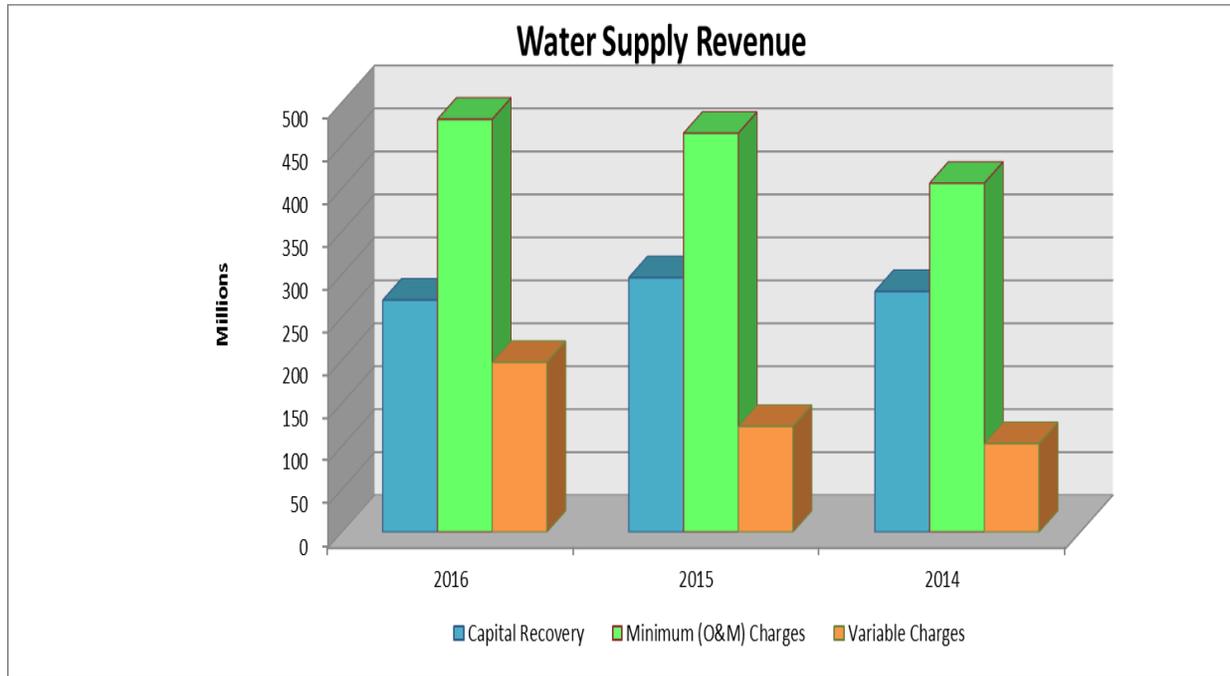
The increase in operating revenues for fiscal 2016 is attributable to an increase in water supply revenue billings due to increased Water Contractor allocations, which resulted in increased water deliveries, and an increase in federal and state reimbursements. These increases were offset by a 7.52% decrease in power sales of 547,144 MWh in fiscal 2016 compared to 591,615 MWh sold in fiscal 2015.

Increases in operating revenues for fiscal 2015 were primarily due to an increase in water supply revenue billings which were based on higher projected capital costs and an increase in the average mill rate. However, power sales decreased 37.11% from 591,615 MWh in fiscal 2015 compared to 940,679 MWh sold in fiscal 2014.

Water Supply Revenue

The largest portion of revenues, approximately 87.25%, comes from Water Supply Revenue. In fiscal 2016, the System generated \$948.1 million in water supply revenue, compared to \$883.5 million in fiscal 2015, and \$789.4 million in fiscal 2014.

The following table shows a comparative breakdown of the components of water supply revenue for fiscal years 2016, 2015, and 2014:

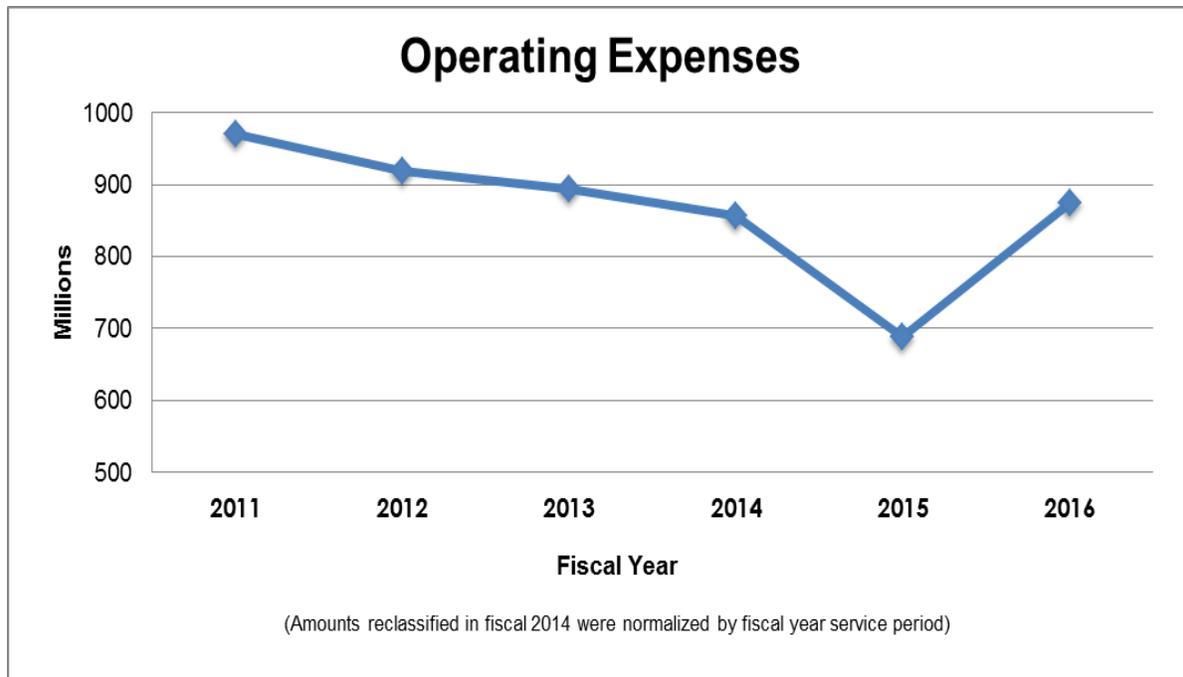


Expenses

Operating Expenses

Total operating expenses increased by \$184.9 million for fiscal 2016 to a total of \$873.8 million. The increase is due to an increment in operations and maintenance expenses, an increment in operating expenses recovered, and increased power purchases.

Total operating expenses decreased by \$178.6 million for fiscal 2015 to a total of \$688.9 million. The decrease is due to a reduction in operations and maintenance expenses and a decrease in power purchases.



Operations and Maintenance Expenses

Total operations and maintenance expenses increase of \$107.3 million in fiscal 2016 was mostly attributed to the following factors:

- \$43.4 million timing difference in the capitalization of construction related expenses for the Perris Dam Remediation Program and other extraordinary repair projects
- \$26.5 million net increase in expenses related to consultant and professional services and repair expenses, pollution remediation, general supplies, and miscellaneous expenses related to general operations and maintenance expenses
- \$28.6 million increase in wages, salaries and pension expense
- \$8.8 million increase in purchased water supply expenses due to the purchase of environmental pulse flow water from Goodwin Dam and the reimbursement to Contra Costa Water District

Total operations and maintenance expenses decrease of \$152.6 million in fiscal 2015 was most significantly attributed to the following factors: \$64.2 million timing difference in the capitalization of construction related expenses for the Hyatt-Thermalito Plant fire recovery and other extraordinary repair projects; \$55.7 million reduction in expenses related to pollution remediation, general supplies, and miscellaneous expenses, as the system deferred extraordinary repair projects and began cost reduction efforts to general operations and maintenance expenses; \$22.8 million reduction in purchased water supply expenses due to the absence of demand under the new multi-year Turnback Water Pool Program; and \$9.8 million reduction in Postemployment Benefits other than Pensions (OPEB).

Power Purchases

In fiscal 2016, power purchases increased by \$16.9 million. This was mainly due to incremental increases in Water Contractor allocations throughout fiscal 2016. The primary factor that contributed to increased water deliveries was attributed to several winter storms during January 2016 through April 2016, which created a run-off into DWR's reservoirs. The increased water allocations resulted in increased pumping demand.

In fiscal 2015, power purchases decreased by \$38.7 million. This is due mainly to a reduction in water deliveries during the year. Primary factors that contributed to decreased water deliveries were continued drought conditions, low reservoir storages and near zero percent snow pack throughout the Sierras.

Operating and Maintenance Expense Recovered

Operating and maintenance expense recovered increased by \$65 million in fiscal 2016. This increase was primarily due to the recognition of \$73 million in deferred operation and maintenance expenses offset by \$8 million decrease in net suspended costs.

In fiscal 2015, the System did not recognize any recovery of operations and maintenance expense.

Capital Revenues Deferred

Capital revenues deferred represents the timing difference between net capital revenue recovered and certain operating costs incurred. Capital revenues recovered decreased by \$125.4 million in fiscal 2016. This decrease was primarily due to the System's reclassification of amounts of Utility Plant Assets (net of accumulated depreciation) for assets co-owned by the System and the United States Bureau of Reclamation, and the defeasance of certain Water System Revenue Bonds related to unamortized capital projects.

Capital revenues recovered increased by \$201 million in fiscal 2015. This increase was primarily due to the System having recognized current year capital revenues of \$202.2 million in excess of annual amounts in depreciation related to the timing difference of capitalized construction expenses on extraordinary repair projects.

Interest Expense

Interest expense increased \$10.8 million in fiscal 2016. A total of \$6.5 million of this increase was attributable to payments related to the issuance of new Revenue Bonds, as well as interest of \$4.8 million related to the cash-defeasance of certain Revenue Bonds during fiscal 2016.

Interest expense for fiscal 2015 decreased \$19.4 million from fiscal 2014. This decrease was predominantly attributed to the lower interest rates achieved through Water System Revenue Bonds refunding.

Capital Assets and Debt Administration

Capital Assets

Investments in capital assets include utility plant and equipment, land, construction work in progress (CWIP), land use rights, computer software, and other intangible assets. The increase in the System's investment in capital assets for fiscal 2016 was \$167 million and for fiscal 2015 was \$63 million, an increase of 4.72% and 1.82%, respectively. Additional details of capital assets are in Note 4.

The System's investment in capital assets is presented below:

Capital Assets

	Balance (in thousands)		
	2016	2015 (As restated)	2014
Nondepreciable Utility Plant	\$ 1,029,435	\$ 868,849	\$ 690,600
Depreciable Utility Plant	4,754,564	4,678,487	4,773,756
Total Utility Plant	5,783,999	5,547,336	5,464,356
Less Accumulated depreciation / amortization	(2,084,676)	(2,014,654)	(1,994,695)
Utility Plant, Net	<u>\$ 3,699,323</u>	<u>\$ 3,532,682</u>	<u>\$ 3,469,661</u>

Long-Term Debt

The System's total debt decreased by \$56.3 million (1.87%) during fiscal 2016. This was comprised of the issuance of approximately \$137.7 million in new debt, net of refunding and defeasances, including financing costs related to construction projects, offset in part by bond principal payments of \$194 million. The change in debt included a cash-defeasance of \$35.6 million of certain Revenue bonds relating to the Off-Aqueduct power facilities. During fiscal 2015, the System's total debt increased by \$67.6 million. This was comprised of new debt of \$259.1 million, net of refunding, and principal payments of \$175.9 million.

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

Long-Term Debt

	Balance (in thousands)		
	2016	2015	2014
Revenue Bonds	\$ 2,770,888	\$ 2,724,008	\$ 2,647,814
General Obligation Bonds	135,045	184,960	241,835
Commercial Paper	42,776	87,901	36,136
PMIA Loan	-	8,094	11,579
Total	2,948,709	3,004,963	2,937,364
Less current portion	(180,930)	(189,479)	(175,941)
Long-term portion	<u>\$ 2,767,779</u>	<u>\$ 2,815,484</u>	<u>\$ 2,761,423</u>

Additional information on the System's long-term debt can be found in Notes 6 and 7 of this report.

Economic Factors

The SWP must enter the power market to facilitate the operation of the California aqueduct. Operations continue 24 hours a day, seven days a week, with constant coordination with other utilities, Water Contractors, the California Independent System Operator (CAISO), and SWP pumping and generating plants. The power market, controlled by CAISO, can have a material impact on the power sales revenues and power purchase expenses of the SWP.

Economics, climate changes, and new legislation have required the System to explore and include more renewable energy sources. In 2005, Executive Order S-3-05 was signed into law and in 2006 Assembly Bill (AB-32) was passed, requiring California to reduce its Green House Gas (GHG) emissions to 1990 levels by 2020. By 2050, GHG emission levels must be below 80% of 1990 levels.

As a result of these new laws, California will require a higher percentage of the System's pumping load to be served by renewable energy sources. By 2050, approximately 50% of the System pump load will need to be supplied by renewable energy. During fiscal 2015, the System began purchasing renewable energy under a purchase contract with Dominion Solar-RE Camelot, a 45 MW solar plant. Future solar energy purchases are also forecasted under contracts with Solverde 1 and Pearblossom Solar, which are scheduled to come on line near the end of calendar year 2016 and will add an additional 95 MW of renewable power.

Every year, the SWP is confronted with factors that affect how the operation of the System is conducted. Some factors include plant or unit outages, environmental concerns, weather, fluctuations in natural gas prices, transmission line outages, and wild fires.

Increased water allocations resulted in increased water deliveries and pumping through the SWP. Water deliveries increased from 1.41 million acre-feet in fiscal 2015 to 1.77 million acre-feet in fiscal 2016, an increase of 0.36 million acre-feet or 25.53%. The primary factor that contributed to increased water deliveries in fiscal 2016 was attributed to several winter storms occurring during January 2016 through April 2016, which resulted in an Oroville Lake storage increase from 1 million acre-feet to 3.3 million acre-feet or at 95% full capacity. This increase in the System reservoirs allowed incremental increases to the water allocations.

Since the State of California still remains in a drought condition and the System reservoirs still have not recovered to maintain consistent pre-drought allocations of approximately 60% to the Water Contractors, the priority throughout the State of California is to conserve the limited water that is available. All these factors indicate power sales may remain at lower levels.

Requests for Information

This financial report is designed to provide a general overview of the System's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Chief, Financial Reporting and Analysis Office, 1416 Ninth Street Room 804, Sacramento, CA 95814.



FINANCIAL STATEMENTS

Statements of Net Position

(amounts in thousands)

	2016	2015 (As restated)
	<hr/>	<hr/>
Assets		
Current assets:		
Cash and cash equivalents	\$ 550,968	\$ 517,663
Receivables:		
Interest on investments	1,265	996
Water supply and power billings (net)	119,235	79,527
Due from federal and state governments	38,596	37,406
Due from others	466	408
Inventories	5,171	5,160
Total current assets	<hr/> 715,701	<hr/> 641,160
Long-term assets:		
Restricted assets:		
Cash and cash equivalents restricted for plant replacements	29,436	28,348
Cash and investments restricted for debt service	114,459	118,075
Cash and cash equivalents on deposit with revenue bond trustee	33,435	9,435
Amounts recoverable through future billings under long-term water supply contracts:		
Operations and maintenance expense	277,024	441,755
Capital credit due from water contractors	297,814	231,033
Unamortized project costs	313,045	347,858
Unbilled interest incurred on capital costs	382,848	419,663
Loans receivable from local water agencies	12,968	14,061
Advances to other state funds	92,011	93,047
Total long-term assets	<hr/> 1,553,040	<hr/> 1,703,275
Utility plant:		
Utility plant in service	5,014,128	4,935,436
Less accumulated depreciation	<u>(2,084,676)</u>	<u>(2,014,654)</u>
Net utility plant in service	2,929,452	2,920,782
Construction work in progress	<hr/> 769,871	<hr/> 611,900
Total utility plant	<hr/> 3,699,323	<hr/> 3,532,682
Total assets	<hr/> 5,968,064	<hr/> 5,877,117
Deferred outflows of resources:		
Deferral of loss on refunding	161,656	174,933
Deferral of employer pension contribution	47,978	44,393
Deferral of resources related to pensions	20,597	-
Total deferred outflows of resources	<hr/> 230,231	<hr/> 219,326
Total assets and deferred outflows of resources	<hr/> \$ 6,198,295	<hr/> \$ 6,096,443

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

Statements of Net Position (continued)

(amounts in thousands)

	2016	2015 (As restated)
Liabilities		
Current liabilities:		
Current maturities of bonds	\$ 180,930	\$ 185,815
Accounts payable	115,898	67,575
Accrued vacation	14,528	13,326
Pollution remediation	4,207	10,245
Accrued interest on long-term debt	11,229	11,900
Pooled Money Investment Account (PMIA) Loan	-	3,663
Due to other state funds	39,370	45,065
Proceeds due to water contractors	94,551	86,900
Other current liabilities	-	939
Total current liabilities	460,713	425,428
Long-term liabilities		
General obligation bonds	88,300	135,045
Revenue bonds	2,636,703	2,588,108
Commercial paper	42,776	87,901
Other postemployment benefits	230,198	203,219
Net pension liability	485,502	426,935
Pooled Money Investment Account (PMIA) Loan	-	4,431
Accrued vacation	25,888	29,392
Pollution remediation	44,854	33,579
Unearned revenue - State and Federal capital recovery	12,766	12,766
Advances for plant replacements	32,064	29,459
Total long-term liabilities	3,599,051	3,550,835
Total liabilities	4,059,764	3,976,263
Deferred inflows of resources:		
Operations and maintenance expense	1,929	1,989
Capital costs	774,159	683,469
Power sales credit due to Water Contractors	146,417	149,728
Deferral of resources related to pensions	10,598	79,566
Total deferred inflows of resources	933,103	914,752
Total liabilities and deferred inflows of resources	4,992,867	4,891,015
Net position:		
Net investment in capital assets	1,155,487	1,165,253
Restricted	49,941	40,175
Total net position	1,205,428	1,205,428
Total liabilities, deferred inflows of resources, and net position	\$ 6,198,295	\$ 6,096,443

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

Statements of Revenues, Expenses, and Changes in Net Position
(amounts in thousands)

	<u>2016</u>	<u>2015</u>
Operating revenues:		
Water supply	\$ 948,105	\$ 883,538
Power sales	71,236	91,780
Federal and State reimbursements	67,309	44,060
Total operating revenues	<u>1,086,650</u>	<u>1,019,378</u>
Operating expenses:		
Operations and maintenance	511,926	404,627
Purchased power	219,661	202,780
Depreciation and amortization expense	77,170	81,495
Operating expenses recovered, net	65,004	-
Total operating expenses	<u>873,761</u>	<u>688,902</u>
Income from operations	212,889	330,476
Nonoperating revenue (expenses):		
Capital revenues recovered (deferred), net	(118,510)	(243,945)
Interest expense	(106,978)	(96,082)
Other revenues (expenses), net	<u>12,599</u>	<u>9,551</u>
Change in net position	-	-
Net position, beginning of year	1,205,428	1,205,428
Net position, end of year	<u>\$ 1,205,428</u>	<u>\$ 1,205,428</u>

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



Statements of Cash Flows
(amounts in thousands)

	2016	2015 (As restated)
Cash flows from operating activities:		
Receipts from customers	\$ 1,129,333	\$ 865,978
Payments to employees for services	(363,980)	(351,480)
Payments to suppliers	(319,699)	(283,286)
Other receipts	5,741	2,647
Net cash provided by operating activities	<u>451,395</u>	<u>233,859</u>
Cash flows from capital and related financing activities:		
Proceeds from issuance of revenue obligation bonds including premium	215,805	246,873
Principal payments on long-term debt	(221,370)	(172,455)
Commercial paper notes issued	180,375	191,229
Principal payments on commercial paper notes	(225,500)	(139,465)
Principal payments on PMIA note	(8,094)	(3,486)
Interest payments on long-term debt	(91,841)	(210,661)
Change in long-term provision and net pension liability	(10,400)	30,797
Additions to utility plant and construction work in progress	(243,811)	(144,515)
Net cash used by capital and related financing activities	<u>(404,836)</u>	<u>(201,683)</u>
Cash flows from investing activities:		
Cash received from investment earnings	27,667	6,393
Proceeds of investments matured	100,870	100,865
Purchases of investments	(110,585)	(100,866)
Loan payments from local water agencies	1,094	1,170
Net cash provided by investing activities	<u>19,046</u>	<u>7,562</u>
Net increase (decrease) in cash and cash equivalents	65,605	39,738
Cash and cash equivalents, beginning of year	601,024	561,286
Cash and cash equivalents, end of year	<u>\$ 666,629</u>	<u>\$ 601,024</u>
Noncash capital and related financing activities:		
Amortization of bond premium/discount	\$ 19,637	\$ 15,614
Amortization of deferred loss on refunding	(10,902)	(10,000)
Principal retirements of long-term debt on proceeds received from issuance of Series AS Water System Revenue Bonds	-	689,780
Noncash capital and related financing activities:	<u>\$ 8,735</u>	<u>\$ 695,394</u>

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

Statements of Cash Flows (continued)
(amounts in thousands)

	2016	2015
	<u> </u>	<u>(As restated)</u>
Reconciliation to the statement of net position:		
Cash and cash equivalents	\$ 550,968	\$ 517,663
Restricted assets:		
Cash and cash equivalents restricted for plant replacements	29,436	28,348
Cash and cash equivalents restricted for debt service (net of \$61,669 and \$72,496 of U.S. Agency securities for 2016 and 2015, respectively)	52,790	45,578
Cash and cash equivalents on deposit with revenue bond trustee	33,435	9,435
Cash and cash equivalents	<u><u>\$ 666,629</u></u>	<u><u>\$ 601,024</u></u>
	2016	2015
	<u> </u>	<u>(As restated)</u>
Reconciliation of income from operations to net cash provided by operating activities:		
Income from operations	<u>\$ 212,889</u>	<u>\$ 330,475</u>
Adjustment to reconcile income from operations to net cash provided by operating activities		
Depreciation expense	77,170	81,494
Other receipts	5,741	2,647
(Increase) decrease in deferred charges and credits, net	116,809	(156,123)
Changes in assets and liabilities:		
(Increase) in receivables	(39,766)	(44,866)
(Increase) decrease in inventories	(12)	43
(Increase) decrease in due from federal government	(1,189)	2,023
Increase in accounts payable, accrued vacation, pollution remediation, and other postemployment benefits	77,797	19,607
(Decrease) in due to other state funds	(5,695)	(2,616)
Increase in proceeds due to Water Contractors	7,651	1,175
Total adjustments	<u>238,506</u>	<u>(96,616)</u>
Net cash provided by operating activities	<u><u>\$ 451,395</u></u>	<u><u>\$ 233,859</u></u>

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



NOTES TO FINANCIAL STATEMENTS

1. Reporting Entity

The State Water Resources Development System (System), administered by the Department of Water Resources (DWR), includes the State Water Project (SWP), the Davis-Grunsky Act Program, and the San Joaquin Drainage Implementation Program, was constructed as the result of initial legislation in 1951 and subsequent legislation in the 1960s providing various financing mechanisms. The funds of the System are a part of the primary government of the State of California and are reported as a proprietary fund and business-type activity (non-governmental cost funds) within the State of California's financial statements. The SWP is a system of dams, water storage facilities, aqueducts, pumping stations and electric generation facilities, which have been constructed for purposes of developing firm water supply and conveying water to areas of need within the State and providing flood control, recreation, fish and wildlife enhancement, and hydroelectric power. The System has entered into Water Supply Contracts with 29 customers (Water Contractors) in order to recover substantially all System costs. The 29 Water Contractors are principally located in the San Francisco Bay Area, the Central Coast, the Central Valley and Southern California and their service areas encompass approximately 25% of the State's land area and 69% of its population.

The operations of the System are separate and distinct from other operations of the State of California. The System is accounted for as an enterprise fund comprised of two segments, the Burns-Porter Act and the Central Valley Project Act, and is financed and operated in a manner similar to that of a private business enterprise. The System uses the economic resources measurement focus and the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

2. Summary of Significant Accounting Policies

DWR is a department within the California Natural Resources Agency of the State, and is responsible for the planning, construction, and operation of the System's SWP. The System's operating revenues include water supply, power sales, and Federal and State Reimbursements. Under the Water Supply Contracts, the Water Contractors are required to pay to the System amounts calculated and billed as operating revenues, thus returning to the System substantially all annual operating costs. These operating expenses are comprised of the costs of sales and services, depreciation and amortization of capital assets, power and transmission costs, and administrative expenses.

Revenues from the Water Contractors pledged to the payment of debt, and net investment income are related to capital and financing activities and are defined as non-operating revenues and expenses.

Utility Plant

Utility plant is recorded at original cost. Cost includes labor, materials, and indirect items such as engineering, supervision, transportation, and interest on borrowed funds incurred during construction. Repairs, maintenance, and minor purchases of equipment are charged to expense as incurred.

Depreciation

Depreciation is provided on a straight-line basis over the estimated useful lives of the various classes of utility plant, as follows:

Various Classes of Utility Plant	Estimated Useful Lives
Aqueducts	80 - 100 years
Dams and reservoirs	85 years
Environmental preservation and mitigation	50 years
Power plants	30 - 50 years
Pumping plants	30 - 40 years
Fish protection	35 - 36 years
Facilities	20 - 30 years
Machinery, equipment and vehicles	3 - 5 years
General	1 - 20 years

The System's intangible assets, consisting of software, land use and legal rights, costs associated with the Federal Energy Regulatory Commission (FERC) licenses, and compliance instruments are included in Utility Plant in Service (UPIS). Software costs are amortized on a straight-line basis over a five-to-ten year useful life. Easements are land use rights and considered as either permanent or temporary. Permanent easements have an indefinite useful life and are non-depreciable while temporary easements are being amortized over a five year useful life, unless otherwise specified in the purchase agreement.

A central element of California's Global Warming Solutions Act (AB 32) requires the System to obtain and surrender emission credits and allowances. Currently, these compliance instruments consist of Green House Gas (GHG) emission allowances for the System's share of compliance cost for the Lodi Energy Center (LEC). Since the economic benefit is not diminished until the credits are consumed, they will not be amortized. The credits will be included in UPIS and charged to expense as they are surrendered.

Cash and Cash Equivalents

Cash and cash equivalents, for purposes of the statement of cash flows, includes cash on hand, restricted cash for plant replacements, restricted cash for debt service, and restricted cash on deposit with revenue bond trustee. Such amounts include deposits in the State of California Pooled Money Investment Account (PMIA), Surplus Money Investment Fund (SMIF), and instruments with original maturities of three months or less. Cash and cash equivalents do not include U.S. Government and Agency securities with maturities of more than three months.

Restricted Cash and Investments

Cash and cash equivalents on deposit with revenue bond trustee consists of debt service reserve funds held with a major national bank for the Series 1973 Devil Canyon – Castaic Facilities bonds and amounts held for Reid Gardner Unit 4 contingencies under the termination agreement.

Cash and cash equivalents with the State Treasurer for plant replacements and debt service are restricted as required by the provisions of the Water Supply Contracts and bond resolutions. Restricted funds consist of investments of the same type as those described below.

Investments

Cash not required for current use, including restricted cash, is invested in SMIF, which is stated at fair value. SMIF is part of the State's PMIA, which as of June 30, 2016 and 2015 had a balance of \$77.7 billion and \$71.6 billion, respectively. The weighted average to maturity of PMIA investments was 167 days as of June 30, 2016 and 239 days as of June 30, 2015. The total amount of deposits in SMIF was \$38.0 billion as of June 30, 2016 and \$34.4 billion as of June 30, 2015. The Pooled Money Investment Board (PMIB) has oversight responsibility for SMIF. The Board consists of three members as designated by state statute which shall consist of the State Controller, State Treasurer and Director of Finance. The value of the pool shares in SMIF, which may be withdrawn, is determined on an amortized cost basis, which is different than the fair value of the System's portion of the pool. PMIA funds are on deposit with the State's Centralized Treasury System and are not SEC registered, but are managed in compliance with the California Government Code and State policy. The State's Investment Policy for the PMIA, which is managed by the State Treasurer's Office, sets forth the permitted investment vehicles, liquidity parameters and maximum maturity of investments. These investments consist of U.S. government securities, securities of federally-sponsored agencies, U.S. corporate bonds, interest bearing time deposits in California banks, prime-rated commercial paper, bankers' acceptances, negotiable certificates of deposit, repurchase and reverse repurchase agreements. The PMIA policy limits the use of reverse repurchase agreements subject to limits of no more than 10% of PMIA. The PMIA does not invest in leveraged products or inverse floating rate securities. The PMIA's investment portfolio included deposits in structured notes totaling \$400 million as of June 30, 2016, whereas it did not have any deposits in structured notes as of June 30, 2015. The investment portfolio also included asset-backed securities totaling \$1.719 million as of June 30, 2016 and \$1.448 million as of June 30, 2015.

The System is authorized by statute to invest in the same types of investment vehicles permitted by the State's Centralized Treasury System. U.S. Treasury and agency debt securities are carried at fair value. Because investing is not a core part of the System's mission, the Systems determines that the disclosure related to these investments only need to be disaggregated by major type. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, and is determined from published data (quoted prices) provided by the exchanges, computerized pricing sources, the National Association of Securities Dealers' National Market System, securities custodians and other authoritative sources. Investments made by the System during the year ended June 30, 2016 are of a similar nature as those held at June 30, 2015.

Advances to Other State Funds

Advances to Other State Funds represent the System's advances to DWR's internal service fund that functions as a revolving working capital account for the System.

Receivables

Receivables include amounts due from Water Contractors, organizations that purchase power from the System, Federal and State governments, accrued interest from financial institutions, and other miscellaneous customers.

Inventories

The System carries two types of inventories, operating supplies and fuel. The method of accounting used for operating supplies is first-in, first-out inventory valuation. Fuel station tanks are located throughout the System, and fuel inventory is accounted for using the moving average cost method. Components of inventories at June 30, 2016 and 2015 were as follows:

Inventories		
	2016	2015
Operating supplies	\$ 4,915	\$ 4,967
Fuel	256	193
Total	<u>\$ 5,171</u>	<u>\$ 5,160</u>

Amounts Recoverable through Future Billings

The System records unbilled costs as assets recoverable through future billings under the Water Supply Contracts. These costs include operations and maintenance costs and capital costs.

Unamortized project costs represent abandoned utility plant costs and certain research and development expenses that are recoverable through future billings to the Water Contractors under the terms of the Water Supply Contracts.

Unbilled interest incurred on unrecovered capital costs are classified as other long-term assets until billed under the terms of the Water Supply Contracts. Unbilled interest incurred represents the System's unrecovered interest since inception, recalculated annually at the System's cumulative weighted average cost of borrowing (Project Interest Rate). The System's Project Interest Rate was 4.61% for the years ended June 30, 2016 and 2015.

Deferred Outflows and Inflows

The System has the authority to establish the level of rates necessary to recover generally all System costs, including debt service. As a regulated entity, the System's financial statements are prepared in accordance with the standards established by the Governmental Accounting Standards Board (GASB). The System is considered to be a Regulated Operation pursuant to GASB Statement No. 62, which requires that the effects of the rate-making process are recorded in the financial statements. Accordingly, certain expenses and credits, normally reflected in the change in net position, as incurred, are recognized when included in rates and recovered from or refunded to customers, the state, and the federal government. The System records various regulatory assets and credits to reflect rate-making actions of management. With the implementation of GASB Statement No. 65 and 68, the System records costs related to the loss on refunding, certain employer pension contributions, differences between expected and actual experiences, and unamortized deferred CalPERS market earnings as deferred outflows of resources. Also, with the implementation of GASB Statement No. 65 and 68, the System records revenues that are in excess of total project costs from inception of the SWP as deferred inflows of resources. These costs include capital costs, operations and maintenance costs, power sales credit due to Water Contractors, and unamortized deferred CalPERS market earnings.

Deferred Outflows of Resources

Deferral of loss on refunding represents the difference between the reacquisition price and the net carrying amount of the refunded debt. The unamortized balance of deferred loss on refunding was \$161.6 million as of June 30, 2016 and \$174.9 million as of June 30, 2015. The \$13.3 million decrease is due to the scheduled annual amortization of \$10.9 million on loss of refunding and the write-off of unamortized loss relating to the defeasance of the Off-Aqueduct Power Facilities revenue bonds of \$2.4 million.

The System implemented GASB Statement No. 68 during fiscal 2015. Amounts reported as deferral of employer pension contributions represent the pension contributions made subsequent to the measurement date of the net pension liability. The System paid \$48 million in employer pension contributions during fiscal 2016. Additionally, differences between expected and actual experience are required to be recognized in pension expense in a systematic and a rational manner over a closed period equal to the average of the expected remaining service lives of all employees that are provided with pensions through the pension plan (active employees and inactive employees), beginning with the current period. The System is also required to report its share of the deferred unamortized net loss reported by the CalPERS and the change in proportionate share of net pension liability. The System's allocated share of the deferred outflows of resources related to pensions was \$20.6 million as of June 30, 2016.

Deferred Inflows of Resources

Deferred operations and maintenance expenses represent operations and maintenance revenues collected in excess of operations and maintenance expenses incurred resulting from specific terms of the Water Supply Contracts and timing differences. The System had an ending balance of \$1.9 million and \$2 million in deferred inflows of operations and maintenance expenses as of June 30, 2016 and 2015, respectively.

Since the capital component of revenue allows for the recovery of capital costs plus interest related to the construction of the System's facilities, these revenues are presented as deferred inflows of resources. As these facilities are depreciated over time, the deferred capital costs are recovered.

The power sales credit due to Water Contractors arises from revenue collected for the power generated by the Hyatt-Thermalito Power Plant (HTPP). The power sales credit is amortized over time by a credit issued to the Water Contractors through the Delta Water Charge. The power sales credit decreased by \$3.3 million to an ending balance of \$146.4 million in fiscal 2016 compared to \$149.7 million in fiscal 2015.

The System's allocated share of the deferral of net difference between projected and actual earnings was \$10.6 million during fiscal 2016.

Unearned Revenue – State and Federal Capital Recovery

Unearned Revenue represents reimbursement payments by the State and Federal governments for their share of the System's capital costs in excess of the related depreciation expense recognized in the statements of revenues, expenses, and changes in net position.

Advances for Plant Replacements

Advances for plant replacements represent billings under the terms of the Water Supply Contracts for future replacement of certain System assets. Receipts from such billings are restricted. Costs of plant replacements are charged to this reserve, as incurred.

Bond Issuance Discounts and Premiums

Bond issuance discounts and premiums are reflected as a reduction/increase to the carrying value of the bonds outstanding and are amortized over the lives of the related debt instruments.

Net Position

The System classifies its net position into two components: net investment in capital assets and restricted net position. Net investment in capital assets includes utility plant in service, net of accumulated depreciation, construction work in progress, unamortized project costs, cash reserved for debt service, less debt related to capital assets, unearned revenue, and other assets and liabilities related to the recovery of utility plant. The remaining net position of the System is classified as restricted due to the requirements of legislation that created the System and authorized the construction of the SWP, to use the System's net position solely in support of the SWP, the Davis-Grunsky Act Program, and the San Joaquin Drainage Implementation Program.

Revenues

The cost of providing services from the System is required to be recovered through user charges and other reimbursements. Under the terms of the Water Supply Contracts, the System granted the Water Contractors rate management reductions of approximately \$40.5 million for the years ended June 30, 2016 and 2015. Rate management reductions are reductions in capital related billings to the Water Contractors.

Revenues under the Water Supply Contracts are recognized when billings are due and payable. The billings cover debt service requirements, an additional 25% of revenue bond debt service to satisfy certain bond covenants, current operations and maintenance costs, and past unrecovered costs. The Water Supply Contracts provide that the 25% portion of the billings collected for the purpose of satisfying certain bond covenants be refunded in the subsequent year. These billings, which totaled \$57.8 million and \$54.3 million for the years ended June 30, 2016 and 2015, respectively, are included as Proceeds Due to Water Contractors as presented in the Supplementary Information Debt Service Coverage. The System refunded \$55.1 million and \$53.3 million for the years ended June 30, 2016 and 2015, respectively, to the Water Contractors for the 25% bond cover requirement.

Revenues from the sale of surplus power are recognized as the power is delivered.

The Federal government reimburses the System for certain operating and capital costs incurred by the System for flood control purposes. In addition, the Federal government reimburses the System for the Federal government's 39.72% share of the operating costs of the San Luis joint use facilities and other water facilities. The State of California also reimburses the System for certain operating and capital costs incurred by the System for facilities located within the SWP. Revenue from the State and Federal government in excess of their share of the related depreciation expense is deferred until the related depreciation expense is recognized.

Segments

The System has two segments, which are defined under governmental accounting standards, as an identifiable activity for which one or more revenue bonds or other revenue-backed debt instruments are outstanding:

1) Activities Allowed Under the Burns-Porter Act – This segment accounts for the costs to build, operate, and maintain the facilities financed by General Obligation (GO) bonds as authorized by the Burns-Porter Act. Transportation and conservation revenues from the Water Contractors are recorded in this segment as well as power sales and reimbursements from Federal and State governments and interest on investments. Expenses are limited to operations and maintenance of the SWP constructed with GO bond proceeds, power purchases, replacements, and debt service on the GO bonds.

2) Activities Allowed Under the Central Valley Project Act – This segment accounts for the costs to build, operate, and maintain the facilities financed by the Central Valley Project Water System revenue bonds. Capital and operating revenues from the Water Contractors for projects financed by revenue bond proceeds are recorded in this segment, as well as commercial paper sales, reimbursements from Federal and State governments for the San Luis Dam and Reservoir, Suisun Marsh, recreation costs, and interest on investments. Expenses are limited to the construction and operation of SWP facilities constructed with revenue bond proceeds and power facilities and debt service payments on the revenue bonds.

Restatements

Certain amounts presented in the prior year have been restated in order to conform to the current year's presentation. These restatements were necessary in order to more accurately present amounts of Utility Plant Assets, net of accumulated depreciation, for assets co-owned by the System and the United States Bureau of Reclamation.

Statements of Net Position

	Balance Previously reported at June 30, 2015	Restatement	June 30, 2015 (After Restatement)
Assets			
Utility plant:			
Utility plant in service	\$ 5,064,102	(128,666)	\$ 4,935,436
Less accumulated depreciation	(2,074,899)	60,245	(2,014,654)
Construction work in progress	626,600	(14,700)	611,900
Long-term liabilities			
Unearned revenue - State and Federal capital recovery	155,448	(142,682)	12,766
Deferred inflows of resources:			
Capital costs	623,908	59,561	683,469
Net position:			
Net investment in capital assets	\$ 1,105,692	59,561	\$ 1,165,253
Restricted	99,736	(59,561)	40,175

3. Interests in Jointly Owned Facilities

At June 30, 2016 and 2015, the System owned the following undivided interests in jointly-owned facilities:

Interests in Joint-Use Facilities			System's Portion Based on % Owned			
	Joint Party	% Owned by System	UPIS/CWIP		Accum Depreciation	
			2016	2015	2016	2015
San Luis Joint-Use Facilities	USBR	55%	\$ 244,741	\$ 230,020	\$ 80,392	\$ 75,281
SWP Hydropower Facilities License	LADWP	50%	\$ 1,499	\$ 215	\$ -	\$ -

* Certain amounts have been reclassified from amounts previously reported to conform with the current year presentation.

The amounts above include the System's share of direct costs related to constructing the facilities. Each participant provides its own financing for the jointly-owned facility.

DWR is the operator of the San Luis Joint-Use Facilities. All of the operating expenses related to these facilities are included as operating expenses in the statement of revenues, expenses, and changes in net position. The Federal government is billed for its share of the operating expenses and these billings are included as operating revenues in the statement of revenues, expenses, and changes in net position.

4. Utility Plant

The summarized activity of the System's utility plant during 2016 is presented below:

Utility Plant June 30, 2016				
	Beginning Balance (As restated)	Transfers and Additions	Transfers and Deletions	Ending Balance
Nondepreciable Utility Plant:				
Land	\$ 141,874	\$ 5,807	\$ -	\$ 147,681
Construction work in progress (CWIP)	611,900	232,017	(74,046)	769,871
Land use rights	11,630	130	-	11,760
Other intangible assets	103,445	3,551	(6,873)	100,123
Total nondepreciable utility plant	<u>868,849</u>	<u>241,505</u>	<u>(80,919)</u>	<u>1,029,435</u>
Depreciable Utility Plant:				
Aqueducts	2,169,352	2,629	-	2,171,981
Dams & reservoirs	708,303	-	-	708,303
Power plants	441,202	29,616	-	470,818
Pumping plants	826,704	12,176	-	838,880
Environmental preservation and mitigation	67,797	-	-	67,797
Fish protection	33,934	1,610	-	35,544
Facilities	254,741	17,224	-	271,965
Equipment and other depreciable assets	77,384	9,001	(7,156)	79,229
Computer software	24,531	186	-	24,717
Land use rights	272	-	-	272
Other intangible assets	12,005	-	-	12,005
General	62,262	10,791	-	73,053
	<u>4,678,487</u>	<u>83,233</u>	<u>(7,156)</u>	<u>4,754,564</u>
Less: accumulated depreciation	(1,990,485)	(73,406)	7,148	(2,056,743)
Less: accumulated amortization	(24,169)	(3,764)	-	(27,933)
	<u>(2,014,654)</u>	<u>(77,170)</u>	<u>7,148</u>	<u>(2,084,676)</u>
Total depreciable plant	<u>2,663,833</u>	<u>6,063</u>	<u>(8)</u>	<u>2,669,888</u>
Total Utility Plant - net	<u>\$ 3,532,682</u>	<u>\$ 247,568</u>	<u>\$ (80,927)</u>	<u>\$ 3,699,323</u>

The summarized activity of the System's utility plant during 2015 is presented below:

Utility Plant June 30, 2015

	Beginning Balance	Transfers and Additions	Transfers and Deletions	Ending Balance (As restated)
Nondepreciable Utility Plant:				
Land	\$ 137,033	\$ 4,841	\$ -	\$ 141,874
Construction work in progress (CWIP)	438,244	222,089	(48,433)	611,900
Land use rights	11,583	47	-	11,630
Other intangible assets	103,740	3,815	(4,110)	103,445
Total nondepreciable utility plant	<u>690,600</u>	<u>230,792</u>	<u>(52,543)</u>	<u>868,849</u>
Depreciable Utility Plant:				
Aqueducts	2,167,237	22,266	(20,151)	2,169,352
Dams & reservoirs	781,408	-	(73,105)	708,303
Power plants	466,358	-	(25,156)	441,202
Pumping plants	836,814	-	(10,110)	826,704
Environmental preservation and mitigation	67,797	-	-	67,797
Fish protection	33,934	-	-	33,934
Facilities	246,397	10,515	(2,171)	254,741
Equipment and other depreciable assets	75,705	3,138	(1,459)	77,384
Computer software	24,529	12	(10)	24,531
Land use rights	272	-	-	272
Other intangible assets	11,995	10	-	12,005
General	61,310	952	-	62,262
	<u>4,773,756</u>	<u>36,893</u>	<u>(132,162)</u>	<u>4,678,487</u>
Less: accumulated depreciation	(1,974,282)	(77,739)	61,536	(1,990,485)
Less: accumulated amortization	(20,413)	(3,756)	-	(24,169)
	<u>(1,994,695)</u>	<u>(81,495)</u>	<u>61,536</u>	<u>(2,014,654)</u>
Total depreciable plant	<u>2,779,061</u>	<u>(44,602)</u>	<u>(70,626)</u>	<u>2,663,833</u>
Total Utility Plant - net	<u>\$ 3,469,661</u>	<u>\$ 186,190</u>	<u>\$ (123,169)</u>	<u>\$ 3,532,682</u>

5. Investments

The following is a summary of the System's investments by percentage of total and their related credit ratings as of June 30, 2016:

Investments 2016							
	% of Total Inv	Credit Rating (S&P)	Maturities				Investment Value
			Under 30 Days	31-180 Days	181-365 Days	1-5 Years	
Investments:							
PMA	87%	Not Rated	\$ -	\$ -	\$ 633,193	\$ -	\$ 633,193
US Federal Agency Notes							
Federal National Mortgage Association	1%	AA+	-	-	-	9,913	9,913
Federal Home Loan Bank	7%	AA+	-	51,756	-	-	51,756
							<u>694,862</u>
Investment with Fiscal Agent							
US Bank Money Market Funds	5%	AAA	33,435	-	-	-	33,435
Total Investments							<u>\$ 728,297</u>

The following is a summary of the System's investments by percentage of total and their related credit ratings as of June 30, 2015:

Investments 2015							
	% of Total	Credit Rating (S&P)	Maturities				Investment Value
			Under 30 Days	31-180 Days	181-365 Days	1-5 Years	
Investments:							
Money Market Mutual Funds	0%	Not Rated	\$ 3	\$ -	\$ -	\$ -	\$ 3
PMA	88%	Not Rated	-	-	591,586	-	591,586
US Federal Agency Notes							
Federal National Mortgage Association	3%	AA+	-	-	10,211	10,472	20,683
Federal Home Loan Bank	8%	AA+	-	51,814	-	-	51,814
							<u>664,086</u>
Investment with Fiscal Agent							
US Bank Money Market Funds	1%	AAA	9,435	-	-	-	9,435
Total Investments							<u>\$ 673,521</u>

Interest Rate Risk: In accordance with its investment policy, the State of California manages its exposure to declines in fair value by spreading investments over the various maximum maturities: U.S. Treasury securities, 5 years; federal agency securities, 5 years; bankers acceptances – domestic and foreign, 180 days; certificates of deposits, 5 years; collateralized time deposits, 5 years; commercial paper, 270 days; corporate bonds and notes, 5 years; repurchase agreements and reverse repurchase agreements, 1 year; negotiable order of withdrawal, open ended.

Custodial Credit Risk: For deposits, custodial credit risk is that in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party.

The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code does not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments, other than the following provision for deposits: the California Government Code requires that a financial institution secure deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by a depository regulated under state law. The market value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. California law also allows financial institutions to secure deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits.

Credit Risk: PMIA funds are on deposit with the State's Centralized Treasury System and are managed in compliance with the California Government Code, according to a statement of investment policy discussed in Note 2. The PMIA is not rated.

Concentration of Credit Risk: The PMIA's concentration of credit risk is limited by spreading the investment mix over different investment types, credit ratings and issuers to minimize the impact any one industry, investment class, or institution can have on the PMIA portfolio. The System's PMIA investments totaled \$633,193 and \$591,586 for the fiscal years ended June 30, 2016 and 2015, respectively. Investments outside the State's Centralized Treasury System totaled \$95,104 and \$81,132 for the fiscal years ended June 30, 2016 and 2015, respectively. As of June 30, 2016 and 2015, 8% and 11%, respectively, of the System's investments were in U.S. Agency Securities. There is no limitation on amounts invested in these quoted market price Level 1 types of issues. The remaining investments, \$33,435 and \$9,435 for the years ended are comprised of cash on deposit with Fiscal Agents in short term money market instruments (cash and cash equivalents).

Interest on deposits in PMIA varies with the rate of return of the underlying portfolio and averaged 0.434% and 0.269% for the years ended June 30, 2016 and 2015, respectively. For the years ended June 30, 2016 and 2015, interest earned on the deposits with PMIA approximated \$ 2.9 million and \$1.6 million, respectively. Interest earned is included in the other revenues (expenses) line item on the statement of revenues, expenses, and changes in net position.

The System categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles (GAAP) and in accordance with GASB Statement No. 72. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs.

The U.S. Federal Agency Securities of \$61.7 million are valued using quoted market prices (Level 1 input). Income is comprised of interest, dividends, realized gains and losses, and unrealized gains and losses due to changes in the fair value of investments held at year-end. The change in recurring fair value of the System's Level 1 investments, U.S. Federal Agency Securities, is calculated as follows:

Change in Fair Value Level 1 Investments

	<u>2016</u>	<u>2015</u>
Fair Value of investments at the beginning of the fiscal year	\$ 72,497	\$ 72,388
Less: Proceeds of investments matured in fiscal year	(110,585)	(100,865)
Add: Purchase of investments in fiscal year	100,870	100,866
Add: Amortization of discounts	47	1,440
Change in fair value of investments during fiscal year	<u>(1,160)</u>	<u>(1,332)</u>
Fair value of investments at the end of the fiscal year	<u>\$ 61,669</u>	<u>\$ 72,497</u>

6. Long-Term Debt

The following is a summary of changes in long-term debt for the years ended June 30, 2016 and 2015:

Long-Term Debt

	Revenue Bonds				General	Commercial	PMA	Total Long
					Obligation	Paper	Loan	Term Debt
	Par Amount	Unamortized Discount	Unamortized Premium	Total Revenue Bonds	Par Amount	Par Amount	Loan Amount	
Balance at June 30, 2014	\$2,455,645	\$ (10)	\$ 192,179	\$2,647,814	\$241,835	\$ 36,136	\$11,579	\$ 2,937,364
Additions	795,040	-	141,613	936,653	-	191,230	-	1,127,883
Retirements	(689,780)	-	(39,485)	(729,265)	-	(139,465)	-	(868,730)
Amortization	-	1	(15,615)	(15,614)	-	-	-	(15,614)
Payments	<u>(115,580)</u>	<u>-</u>	<u>-</u>	<u>(115,580)</u>	<u>(56,875)</u>	<u>-</u>	<u>(3,485)</u>	<u>(175,940)</u>
Balance at June 30, 2015	2,445,325	(9)	278,692	2,724,008	184,960	87,901	8,094	3,004,963
Additions	215,805	-	22,167	237,972	-	180,375	-	418,347
Retirements	(35,555)	1	(3,012)	(38,566)	-	(225,500)	-	(264,066)
Amortization	-	1	(16,627)	(16,626)	-	-	-	(16,626)
Payments	<u>(135,900)</u>	<u>-</u>	<u>-</u>	<u>(135,900)</u>	<u>(49,915)</u>	<u>-</u>	<u>(8,094)</u>	<u>(193,909)</u>
Balance at June 30, 2016	2,489,675	(7)	281,220	2,770,888	135,045	42,776	-	2,948,709
Less current portion	<u>(134,185)</u>	<u>-</u>	<u>-</u>	<u>(134,185)</u>	<u>(46,745)</u>	<u>-</u>	<u>-</u>	<u>(180,930)</u>
Total Long-term Debt	<u>\$2,355,490</u>	<u>\$ (7)</u>	<u>\$ 281,220</u>	<u>\$2,636,703</u>	<u>\$ 88,300</u>	<u>\$ 42,776</u>	<u>\$ -</u>	<u>\$ 2,767,779</u>

General Obligation Bonds

The Burns-Porter Act authorized the issuance of State Water Resources Development System (SWRDS) GO Bonds in the amount of \$1,750 million for construction of the System. This amount included \$130 million to be set aside for financial assistance to local water agencies as provided in the Davis-Grunsky Act. The Burns-Porter Act also made a continuing appropriation of the California Water Fund, a fund unrelated to the System, to supplement the bond authorization. To the extent California Water Fund money was used for construction of the State water facilities in lieu of bond proceeds, an equal amount of bond authorization was set aside to be used only for the construction of additional facilities of the System that met certain requirements set forth in the Burns-Porter Act.

Under the Burns-Porter Act, revenues of the System, other than revenues attributable to facilities financed with Water System Revenue Bonds, are deposited in the California Water Resources Development Bond Fund and are to be used annually only for the following purposes and in the following order of priority:

- 1) To pay the maintenance, operation and replacement costs of the System,
- 2) To pay, or reimburse the General Fund of the State for, the principal of and interest on the SWRDS GO Bonds issued for the System as it becomes due,
- 3) To reimburse the California Water Fund for funds utilized from said fund for construction of the System (complete reimbursement has been made), and
- 4) To pay additional costs of the acquisition and construction of the System.

All such revenues are pledged for these uses and purposes for the benefit of the owners of the SWRDS GO Bonds.

As of June 30, 2016, the amount of the revenues pledged to repay the Burns-Porter Act SWRDS GO Bonds debt service is \$148.9 million with payments through 2025. Principal and interest paid for the current year was \$57.7 million and Burns-Porter Act water supply operating revenues were \$693 million. As of June 30, 2015, the amount of the revenues pledged to repay the Burns-Porter Act SWRDS GO Bonds debt service was \$206.6 million. Principal and interest paid for 2015 was \$66.9 million and Burns-Porter Act SWRDS water supply operating revenues were \$657.6 million.

SWRDS GO Bonds of \$168 million are authorized but un-issued as of June 30, 2016 and 2015, and may only be used for additional facilities, meeting certain requirements of the Burns-Porter Act.

Outstanding SWRDS GO Bonds include Series F through Series S, which may be called at any time for early redemption. SWRDS GO Bonds Series X and Y do not have early redemption provisions.

SWRDS GO Bonds consist of the following at June 30, 2016:

General Obligation Bonds				Amounts Outstanding	
Fiscal Year of Issue	Series	Fixed Rates	Fiscal Year of Final Maturity	2016	2015
1966	E	3.0%	2016	\$ -	\$ 4,500
1967	F	3.5%	2017	4,500	8,900
1967	G	3.5%	2017	4,500	8,900
1967	H	3.0%	2017	4,500	8,900
1968	J	3.5%	2018	8,900	13,200
1968	K	4.0%	2018	8,900	13,200
1969	L	4.5%	2019	13,200	17,300
1969	M	4.0-4.9%	2019	13,200	17,300
1970	N	5.0%	2020	17,300	21,300
1970	P	5.0-5.8%	2020	17,300	21,300
1971	Q	4.8-5.0%	2021	21,300	25,200
1971	R	4.8-5.0%	2021	10,650	12,600
1972	S	5.3-5.5%	2022	10,080	11,560
1994	X	4.8%	2024	400	450
1995	Y	7.0-7.1%	2025	315	350
Total General Obligation bond debt outstanding at par				135,045	184,960
Less current maturities				(46,745)	(49,915)
Total Long-term General Obligation bond debt outstanding				<u>\$ 88,300</u>	<u>\$ 135,045</u>

Revenue Bonds

The Water System Revenue Bonds have been issued for the acquisition or construction of projects to provide water and power for the SWP. Under the statute pursuant to which Water System Revenue Bonds are issued, principal and interest on the bonds are secured by and payable solely from revenues attributable to the facilities financed by the bonds. These are primarily payments under the Water Supply Contracts between the System and Water Contractors.

As of June 30, 2016, the amount of the revenues pledged to repay the Water System Revenue Bonds debt service is \$3,457 million with payments through Fiscal 2036. Principal and interest paid for the current year was \$237.2 million and CVP water supply operating revenues were \$255.1 million. As of June 30, 2015, the amount of the revenues pledged to repay the Water System Revenue Bonds debt service were \$3,429 million with payments through 2036. Principal and interest paid for the year was \$208 million and CVP water supply operating revenues were \$225.9 million.

On September 2, 2015, the System issued \$109.3 million of Water System Revenue bonds (Series AU) to redeem \$104.6 million of Commercial Paper Notes Series 1. The Series AU was issued as index floating rate notes using the weekly SIFMA Index, plus a 0.62% spread to calculate monthly debt service payments, with a rate not to exceed 8.0% per annum. The Series AU bonds have a mandatory tender date of September 1, 2017 and can be called on or after March 1, 2017, at a purchase price of 100% of the principal amount. The Series AU bonds are not subject to optional tender by the holders of the bonds. The interest rates for Series AU bonds ranged from 0.63% to 1.05% and averaged 0.76% in fiscal year 2016.

On May 24, 2016, the System issued tax-exempt Water System Revenue bonds (Series AV) with a par amount of \$106.5 million and a Premium of \$22.2 million to redeem \$120.9 million of Commercial Paper Notes Series 1. The Series AV was issued with fixed coupon rates of 4.0% and 5.0%, and maturities ranging from 2018 to 2035. The Series AV bonds maturing on or after December 1, 2026 will be subject to redemption prior to their stated maturities, at a redemption price equal to the bonds being redeemed, plus accrued interest, without premium.

On November 6, 2014, the System issued \$149.2 million of Water System Revenue bonds (Series AT) to redeem \$139.5 million of Commercial Paper Notes Series 1. The Series AT was issued as index floating rate notes using the weekly SIFMA Index, plus a 0.30% spread to calculate monthly debt service payments, with a rate not to exceed 8.0% per annum. The Series AT bonds have a mandatory tender date of December 1, 2017 and can be called on or after June 1, 2017, at a purchase price of 100% of the principal amount. The Series AT bonds are not subject to optional tender by the holders of the bonds. The interest rates for the Series AT bonds ranged from 0.31% to 0.73% and averaged 0.42% in fiscal year 2016.

The System is subject to certain bond covenants, the most restrictive of which requires that the revenues in each year shall be at least equal to 1.25 times the debt service payable from revenues on all bonds outstanding in such year, plus operating costs, and the required funding of the debt service reserve account. The bonds are limited special obligations of the System; neither the principal nor any interest thereon constitutes a debt of the State. Certain bonds are redeemable prior to maturity at a redemption price of 100%.

Water System Revenue Bonds consist of the following at June 30, 2016:

CVP Revenue Bonds						Amounts Outstanding	
Fiscal Year of Issue	Series	Fixed Rates	Fiscal Year of Final Maturity	Fiscal Year of First Call Date	2016	2015	
Devil Canyon-Castaic Facilities:							
1973	A&B	5.3-5.4%	2023	1983	\$ 51,625	\$ 57,430	
CVP Water System:							
1999	V	6.3%	2025	None	18,050	20,235	
2002	X	5.5%	2018	2013	29,975	51,465	
2008	AE	3.4-5.0%	2030	2018	74,365	96,080	
2009	AF	3.0-5.0%	2030	2019	98,765	103,445	
2010	AG	3.0-5.0%	2033	2020	26,980	27,330	
2011	AH	3.3-5.3%	2036	2021	58,640	63,985	
2012	AI	5.0%	2030	2022	74,910	92,275	
2012	AJ	4.0-5.0%	2036	2022	161,960	185,985	
2012	AK	3.0-5.0%	2036	2022	27,415	29,695	
2013	AL	5.0%	2030	2023	67,750	78,855	
2013	AM	5.0%	2026	2023	156,045	157,570	
2013	AN	4.0-5.0%	2036	2023	41,330	42,855	
2013	AO	1.0-3.5%	2030	None	278,240	317,505	
2013	AP	3.0-5.0%	2036	2023	42,460	43,925	
2013	AQ	4.0-5.0%	2036	2023	117,855	120,205	
2014	AR	4.0-5.0%	2036	2024	156,400	161,445	
2015	AS	2.0-5.0%	2033	2025	641,860	645,795	
2015	AT	Variable	2036	2017	149,245	149,245	
2016	AU	Variable	2036	2017	109,275	-	
2016	AV	4.0-5.0%	2029	2026	106,530	-	
Total CVP Water System Revenue Bonds					2,438,050	2,387,895	
Total revenue bond debt outstanding at par					2,489,675	2,445,325	
Unamortized bond issuance premiums					281,220	278,692	
Unamortized bond issuance discounts					(7)	(9)	
Current fiscal maturities					(134,185)	(135,900)	
Total long-term bond debt outstanding					\$ 2,636,703	\$ 2,588,108	

Future Debt Service Requirements

Future principal and interest payment requirements on the bonds are as follows at June 30, 2016:

Future Debt Service Requirements							
Year	Revenue Bonds			General Obligation Bonds			All Bonds
	Principal	Interest	Total	Principal	Interest	Total	Total
2017	\$ 134,185	\$ 104,649	\$ 238,834	\$ 46,745	\$ 5,660	\$ 52,405	\$ 291,239
2018	138,570	98,710	237,280	34,235	3,792	38,027	275,307
2019	131,360	93,178	224,538	25,975	2,414	28,389	252,927
2020	140,945	87,471	228,416	17,405	1,386	18,791	247,207
2021	141,200	81,282	222,482	8,595	527	9,122	231,604
2022-2026	704,690	309,332	1,014,022	2,090	125	2,215	1,016,237
2027-2031	622,850	150,015	772,865	-	-	-	772,865
2032-2036	475,875	42,724	518,599	-	-	-	518,599
	<u>\$2,489,675</u>	<u>\$967,361</u>	<u>\$3,457,036</u>	<u>\$135,045</u>	<u>\$13,904</u>	<u>\$148,949</u>	<u>\$3,605,985</u>

* Includes variable rate bonds for Series AT and Series AU, which bear interest at a weekly rate.

An assumed rate of 3.0% for Series AT and 2.07% for Series AU was used to project the variable portion of the interest payments in this table. The interest rate still in effect was determined at issuance date using the Securities Industry and Financial Markets Association (SIFMA) Swap 10 year average Index plus an applicable basis point spread.

Pooled Money Investment Loan (PMIA)

On March 26, 2008, the System received a loan of \$29.6 million from the Pooled Money Investment Account (PMIA) pursuant to California Government Code section 16313. The proceeds of the loan were used to establish escrow accounts that facilitated defeasance of certain Water System Revenue Bonds that financed recreation, and fish and wildlife enhancement related costs of the acquisition and construction of the System. The loan, which was scheduled to be repaid in fiscal year 2018, was paid in full on December 1, 2015.

The loan was repaid with surplus revenues of the System made available under California Water Code section 12937(b)(4). The loan agreement required minimum quarterly payments of \$1 million on the first day of every March, June, September, and December, which included principal and interest, beginning on September 1, 2008. Principal and interest paid during fiscal years 2016 and 2015 were \$8.3 million and \$4 million, respectively. Interest was computed on the unpaid principal balance of the loan at the Variable Rate on the basis of a 360-day year or twelve 30-day months and the number of days elapsed.

The Variable Rate means:

- a) for the period from the date of the Loan Agreement, March 26, 2008, through and including the day before the first Reset Date (March 25, 2009), five percent per annum, and
- b) for each Renewal Period thereafter, the greater of
 - (i) five percent per annum, or
 - (ii) the last available daily rate of return by the PMIA on the day before the Reset Date on which such Renewal Period commences.

Commercial Paper Notes

The System has a commercial paper borrowing program of up to \$139.7 million. Under this program, the System may issue commercial paper at prevailing interest rates for periods of not more than 270 days from the date of issuance. To provide liquidity for the programs, the System entered into a revolving credit agreement with a commercial bank equal to the authorized amount of commercial paper. Under the credit agreement dated October 1, 2011 and the first amendment dated May 28, 2014, the bank has agreed to make advances to the System, if necessary, to provide monies for the payment of the Commercial Paper Notes Series 1. The bank is obligated to provide \$150 million, with the principal amount of Commercial Paper Notes Series 1 limited to \$139.7 million and \$10.3 million of accrued interest, calculated for sizing purposes at 10% per annum for 270 days on a maximum principal commitment of \$139.7 million. The Line of Credit was extended on May 11, 2014 and is scheduled to expire on October 24, 2017, but can be extended for up to three years upon the System's written request and approval from the bank. The credit agreement requires quarterly payments on the first day of July and October and on the last day of December and March. As of June 30 2016, there were no borrowings with the bank under the revolving credit agreement; however, the amounts of Commercial Paper Notes Series 1 outstanding under this program were \$42.8 million on June 30, 2016 and \$87.9 million on June 30, 2015. The weighted average rate for interest expense approximated 0.12% for the year ended June 30, 2016 and 0.07% for the year ended June 30, 2015. The proceeds from the issuance of Commercial Paper Notes Series 1 are restricted to construction costs of certain State water projects, reimbursements of construction costs of certain State water projects, and interest and issuance costs of the Commercial Paper Notes Series 1. The liability has been classified as long-term as it is the System's policy to redeem the commercial paper outstanding with the issuance of Water System Revenue Bonds. The System's obligation to make debt service payments on the Commercial Paper Notes Series 1 is subordinate to its payment obligations under the resolutions for the Water System Revenue Bonds and SWRDS GO Bonds.

The Water Supply Contracts, in their original form, provide for two charges to the Water Contractors: (a) a Delta Water Charge and (b) a Transportation Charge. These charges are computed to return to the State the costs of the facilities necessary to deliver water to the Water Contractors, including capital costs (with interest) and operation and maintenance costs, and expressly including in the case of the facilities to be financed with commercial paper and the related Water System Revenue Bonds, debt service and 1.25 debt service coverage requirements to be satisfied from revenues. DWR expects to redeem its commercial paper liability with proceeds of the additional commercial paper draws until DWR issues Water System Revenue Bonds to provide permanent financing for those Water System Projects financed with Commercial Paper Notes Series 1.

7. Bond Refundings and Defeasances

During fiscal 2016, the System defeased certain Water System Revenue Bonds relating to the Off-Aqueduct Power Facilities. The System did not have any refunding transactions during fiscal 2016. However, in prior years, the System has issued refunding bonds to refund various previous issues. The net proceeds from refunding sales or cash defeasances are used to purchase State and Local Government Series Securities (SLGS) and U.S. Treasury securities, and are deposited in irrevocable escrow trust accounts with an escrow agent as an independent fiscal agent to provide for all future debt service on the bonds being refunded. As a result, those bonds are considered to be defeased, and the related liabilities have been excluded from the System's basic financial statements. At June 30, 2016 and 2015, outstanding Water System Revenue Bonds of \$726.2 million and \$690.8 million, respectively, are considered to be defeased.

On June 24, 2016, the System cash-defeased \$35.6 million of Water System Revenue bonds relating to the Off-Aqueduct Power Facilities, which included Reid Gardner, Bottle Rock, and South Geysers, using proceeds from a termination settlement agreement with the Nevada Power Company. This defeasance resulted in a cash flow savings of \$2 million. The System deposited cash and certain investment securities in an irrevocable escrow with the Treasurer of the State of California, acting as Trustee and Escrow Agent. The par amounts of the defeased bonds are as follows:

Summary of Off-Aqueduct Defeased Bonds	
Bond Series	Amount
Series AE	\$ 2,005
Series AH	3,075
Series AI	2,775
Series AJ	790
Series AK	60
Series AL	6,395
Series AN	385
Series AO	6,175
Series AS	3,935
Series V	2,185
Series X	7,775
Total	<u>\$ 35,555</u>

Amortization of all deferred refunding costs was approximately \$13.3 million in fiscal 2016 and \$10 million in fiscal 2015.

8. Retirement Plan

The State is a member of the California Public Employees' Retirement System (CalPERS), an agent multiple-employer defined benefit pension plan. As an enterprise fund, the System is required under GASB 68 to report results pertaining to liability and asset information as of specific dates and within certain time frames. For this report, the following time frames apply:

- Valuation Date June 30, 2014
- Measurement Date June 30, 2015
- Measurement Period July 1, 2014 to June 30, 2015

Plan Description

The State of California is the employer, the Department of Water Resources is the participating Department of the State, and the System reports an allocated share. Departments and agencies within the State of California, including the System, are in a cost-sharing arrangement in which all risks and costs are shared proportionately by participating State agencies. The System, for the most part has all its employees enrolled in the State Miscellaneous Plan (Tier 1 and Tier 2). CalPERS functions as a common investment and administrative agent for participating public agencies within the State of California using the accrual basis of accounting. All state agencies are considered collectively to be a single employer, and the actuarial present value of vested and non-vested accumulated plan benefits attributable to the System's employees is determined as the System's percentage of the State as a single employer. Net assets available for benefits of the System's employees are also determined as the Systems percentage of the State.

CalPERS issues a publicly available Comprehensive Annual Financial Report that includes financial statements and required supplementary information for CalPERS. CalPERS also issues the GASB 68 Accounting Valuation Report. Copies of these reports may be obtained by logging onto the CalPERS website at www.calpers.ca.gov.

Benefits Provided and Employees Covered

CalPERS provides retirement benefits, survivor benefits, and death and disability benefits based upon employee's years of credited service, age, and final compensation. Vesting occurs after five years of credited service except for second tier benefits, which require ten years of credited service. Most employees who retire at or after age 50 with five or more years of service are entitled to a retirement benefit. New members with service credit beginning on or after January 1, 2013 must be at least age 52. Benefits are payable monthly for the remainder of their lives. Health care and dental benefits, described in Note 10, may be provided to members depending on the date hired and the years of credited service of a member. Several survivor benefit options that reduce a retiree's unmodified benefit are available. Benefit provisions and all other requirements are established by State statute.

Contributions

The contribution requirements of the plan members are established by State statute and the employer contribution rate is established and may be amended by CalPERS. Section 20814(c) of the California Public Employees' Retirement Law (PERF) requires that the employer contribution rates for all public employers be determined on an annual basis by the actuary and shall be effective on the July 1 following notice of a change in the rate. The total plan contributions are determined through the CalPERS' annual actuarial valuation

process. The actuarially determined rate is the estimated amount necessary to finance the costs of benefits earned by employees during the year with an additional amount to finance any unfunded accrued liability. The employer is required to contribute the difference between the actuarially determined rate and the contribution rate of the plan members or employees. These rates reflect section 20683.2, which mandates that certain employees must contribute more as of July 1, 2013. Furthermore, any reduction in employer contributions due to the increase in the employee contributions must be paid by the employer toward the unfunded liability. The following table shows the average active employee and the employer contribution rates for two PERF plans applicable to the System as a percentage of annual pay for the measurement period ended June 30, 2015.

Contribution Rates

June 30, 2015	State Miscellaneous	State Safety
Average active employee rate	6.525%	10.421%
Employer rate of annual payroll	21.137%	17.905%
Total	<u>27.662%</u>	<u>28.326%</u>

Actuarial Methods and Assumptions

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

Actuarial Methods and Assumptions

Actuarial Cost Method	Entry Age Normal
Actuarial Assumptions	
Discount Rate	7.65%
Inflation	2.75%
Salary Increases	Varies by Entry Age and Service
Investment Rate of Return	7.65% net of Pension Plan Investment Expenses, Includes Inflation
Mortality Rate Table	Mortality rates are based on the 2014 CalPERS Experience Study adopted by the CalPERS Board and include 20 years of mortality improvements using Scale BB published by the Society of Actuaries.
Post Retirement Benefit Increase	Contract COLA up to 2.75% until Purchasing Power Protection Allowance Floor on Purchasing Power applies, 2.75% thereafter

Discount Rate

The discount rate used to measure the total pension liability was 7.65%. To determine whether the municipal bond rate should be used in the calculation of a discount rate for each plan, CalPERS stress tested plans that would most likely result in a discount rate that would be different from the actuarially assumed discount rate. Based on the testing of the plans, the tests revealed the assets would not run out. Therefore, the current 7.65% discount rate is appropriate, and the use of the municipal bond rate calculation is not deemed necessary. The long-term expected discount rate of 7.65% is applied to all plans in the Public

Employees Retirement Fund. The stress test results are presented in a detailed report (GASB Crossover Testing Report) that can be obtained at the CalPERS' website.

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

In determining the long-term rate of return, CalPERS took into account both short-term and long-term market return expectations, as well as the expected PERF fund's cash flows. Such cash flows were developed assuming that both members and employers will make their required contributions on time and as scheduled in all future years. Using historical returns of all the fund's asset classes, expected compound (geometric) returns were calculated over the short-term (first 10 years) and the long-term (11-60 years) using a building-block approach. Using the expected nominal returns for both short-term and long-term, the present value of benefits was calculated for each fund. The expected rate of return was set by calculating the single equivalent expected return that arrived at the same present value of benefits for cash flows as the one calculated using both short-term and long-term returns. The expected rate of return was then set equivalent to the single equivalent rate calculated above and rounded down to the nearest $\frac{1}{4}$ of 1%.

The table below reflects long-term expected real rate of return by asset class for PERF. The rate of return was calculated using the capital market assumptions applied to determine the discount rate and asset allocation. The target allocation shown was adopted by the CalPERS Board effective on July 1, 2014.

Long-Term Expected Real Rate of Return by Asset Class

Asset Class	Current Target Allocation	Real Return Years 1 - 10 ¹	Real Return Years 11+ ²
Global Equity	51.0%	5.25%	5.71%
Global Fixed Income	19.0%	0.99%	2.43%
Inflation Sensitive	6.0%	0.45%	3.36%
Private Equity	10.0%	6.83%	6.95%
Real Estate	10.0%	4.50%	5.13%
Infrastructure and Forestland	2.0%	4.50%	5.09%
Liquidity	2.0%	-0.55%	-1.05%
Total	<u>100.0%</u>		

¹An expected inflation of 2.5% used for this period

²An expected inflation of 3.0% used for this period

Pensionable Compensation

The System's allocated share of DWR's annual pensionable compensation as a calculated percentage of the State Employer total for the measurement periods ended June 30, 2015 and 2014 is illustrated in the following tables:

Compensation Amounts and Calculated Percentages

Defined Benefit Retirement Plans	Measurement period July 1, 2014 to June 30, 2015			
	Burns Porter (0502) ¹	Central Valley (0506) ²	System	State Pensionable Compensation
Misc. Tier 1 & 2 Combined	\$ 155,827	\$ 27,099	\$ 182,926	\$ 10,640,884
State Peace Officers & Firefighters	-	-	-	3,115,287
California Highway Patrol	-	-	-	809,610
State Safety	-	-	-	2,003,777
State Industrial	-	-	-	577,711
Judges	-	-	-	28,770
Judges II	-	-	-	180,230
Legislators	-	-	-	1,397
Total	\$ 155,827	\$ 27,099	\$ 182,926	\$ 17,357,665

¹Calculated share of total State pensionable compensation issued by the Office of State Controller at 1.4644% of total miscellaneous plan.

²Calculated share of total State pensionable compensation issued by the Office of State Controller at 0.2547% of total miscellaneous plan.

Compensation Amounts and Calculated Percentages

Defined Benefit Retirement Plans	Measurement period July 1, 2013 to June 30, 2014			
	Burns Porter (0502) ¹	Central Valley (0506) ²	System	State Pensionable Compensation
Misc. Tier 1 & 2 Combined	\$ 142,898	\$ 23,843	\$ 166,742	\$ 9,850,666
State Peace Officers & Firefighters	-	-	-	3,028,235
California Highway Patrol	-	-	-	765,283
State Safety	-	-	-	1,901,180
State Industrial	-	-	-	532,489
Judges	-	-	-	199,245
Judges II	-	-	-	4,805
Legislators	-	-	-	1,471
Total	\$ 142,898	\$ 23,843	\$ 166,742	\$ 16,283,375

¹Calculated share of total State pensionable compensation issued by the Office of State Controller at 1.4506% of total miscellaneous plan.

²Calculated share of total State pensionable compensation issued by the Office of State Controller at 0.2420% of total miscellaneous plan.

Discount Rate Sensitivity

The discount rate used to measure the total pension liability was 7.65% for the System's allocated share of the Plan. In preparation of the GASB 68 Accounting Valuation Report, CalPERS stress tested plans and determined that the 7.65% is adequate. CalPERS is scheduled to review all actuarial assumptions as part of its regular Asset Liability Management review cycle that is scheduled to be completed in February 2018. Any changes to the discount rate will require Board action and proper stakeholder outreach. For these reasons, CalPERS expects to continue using a discount rate net of pension plan investment expenses for GASB Statement No. 67 and 68 calculations through at least the 2017-18 fiscal year. CalPERS will continue to check the materiality of the difference in calculation until such time as CalPERS has changed its methodology.

The following presents the net pension liability of the System's proportionate share of the Plan as of the measurement date, calculated using the discount rate of 7.65%, as well as what the net pension liability would be if it were calculated using a discount rate that is 1 percentage-point lower (6.65%) or 1 percentage-point higher (8.65%) than the current rate:

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

	Discount Rate - 1% 6.65%	Current Discount Rate 7.65%	Discount Rate + 1% 8.65%
Net Pension Liability	\$ 685,705	\$ 485,502	\$ 317,532

Pension Liabilities, Pension Expense and Deferred Outflows and Deferred Inflows of Resources Related to Pensions

As of the start of the measurement period, July 1, 2014, the net pension liability was \$426.9 million.

For the measurement period ending June 30, 2015 (the measurement date), the System incurred a pension expense of \$45.5 million in fiscal 2016.

As of June 30, 2015, the System had deferred outflows and deferred inflows of resources related to pensions as follows:

- Pension contributions made subsequent to the measurement date of \$48 million
- Deferred outflows related to the differences between expected and actual experiences of \$8.9 million and the change in the proportionate share of the net pension liability of \$11.7 million
- Deferred inflows related to the net difference between projected and actual earnings on pension plan investments of \$10.6 million

Exclusive of deferred outflows related to payments after the measurement date, the net amount of deferred outflows (inflows) of resources to pensions that will be recognized in pension expense during the next five years and thereafter is as follows:

Amortization of Deferred Outflows/(Inflows)			
<u>Measurement Period Ended June 30:</u>	<u>Miscellaneous Plan (Inflows)</u>	<u>Miscellaneous Plan Outflows</u>	<u>Miscellaneous Plan Net Deferred</u>
2016	\$ (2,649)	\$ 5,149	\$ 2,500
2017	(2,649)	5,149	2,500
2018	(2,650)	5,149	2,499
2019	(2,650)	5,150	2,500
2020	-	-	-
Thereafter	-	-	-
Total	<u>\$ (10,598)</u>	<u>\$ 20,597</u>	<u>\$ 9,999</u>

9. Postemployment Benefits Other Than Pensions

Post-retirement health care benefits other than pensions are provided by the System to employees through the programs sponsored by the State as administered by CalPERS and the California Department of Human Resources (CalHR). To be eligible for these benefits, employees must retire after attaining certain age and length of service requirements. In addition, annuitants must retire within 120 days of separation from employment to be eligible to receive these benefits. In accordance with the California Government Code, the State generally pays all or a portion of the health and dental insurance costs for annuitants, depending upon the completed years of credited state service at retirement and the coverage selected by the annuitant. The System participates in the State's single-employer plan on a cost sharing basis. The System recognizes the costs of providing health and dental insurance to annuitants based on the required contribution, which is actuarially determined, and is funded on a pay-as-you-go basis. The State's plan, which the System participates in, does not issue separate stand-alone financial statements.

During fiscal 2016, State paid 100% of the health insurance premium for annuitants, and 90% of the additional premium required for the retiree's dependents according to the California Government Code. The maximum monthly State contribution amounts were \$655 for single, \$1,246 for two parties, and \$1,605 for family plan tiers. Dental care insurance premium varies by plan and number of dependents. The contribution requirements of retirees and the State are established and may be amended by the State legislature.

The System's required contributions and resulting net OPEB obligation is as follows:

Net OPEB Obligations		
	2016	2015
Annual required contribution (ARC)	\$ 41,174	\$ 42,008
Interest on net OPEB obligation	7,010	6,824
Adjustment to the ARC	<u>(6,513)</u>	<u>(6,340)</u>
Annual OPEB cost	41,671	42,492
Contributions made	<u>(14,692)</u>	<u>(16,042)</u>
Increase in net OPEB obligation	26,979	26,450
Net OPEB obligation - beginning of year	<u>203,219</u>	<u>176,769</u>
Net OPEB obligation - end of year	<u>\$ 230,198</u>	<u>\$ 203,219</u>

The System's annual required contribution, percentage of the ARC contributed to the plan, and the net OPEB obligation for the years ended June 30, 2016, 2015 and 2014, were as follows:

Annual Required Contribution			
Fiscal Year Ended	Annual Required Contribution	Percentage of ARC Contributed	Net OPEB Obligation
6/30/14	\$ 55,239	35%	\$ 176,769
6/30/15	42,008	38%	203,219
6/30/16	41,174	35%	230,198

The annual OPEB cost (AOC) recorded by the System is calculated by the State and represents an allocation of the total ARC of the State, adjusted for interest and other adjustments. The allocation of retiree health benefit costs is based on the number of active employees funded by the System in relation to DWR's total retiree health benefits costs.

The actuarial valuation report for OPEB may be obtained by writing to the Office of State Controller Betty T. Yee, P.O. Box 942850, Sacramento, CA 94250 or by visiting the State Controller's website at www.SCO.ca.gov. The System's' ARC, AOC and Net OPEB obligation will be calculated and adjusted for on an annual basis.

10. Commitments and Contingencies

Commitments

Construction

The System has entered into long-term construction contract commitments for the State Water Project facilities. The remaining value of contracts in process as of June 30, 2016 and 2015, approximated \$51.1 million and \$61.7 million, respectively.

Power Transmission and Purchase

The System enters into contracts to purchase power as well as transmission service contracts to transmit power. Additionally, the System has expanded the power purchase portfolio to include solar energy and is exploring other potential renewable energies.

The System has long-term transmission service contracts with anticipated future payments of approximately \$101.6 million over periods ranging from one to 26 years. Payments made under these contracts approximated \$4.5 million and \$6.2 million for the years ended June 30, 2016 and 2015, respectively.

The System has long-term power purchase contracts with anticipated future payments of approximately \$662.6 million over periods ranging from one to 26 years. The remaining amounts of fixed obligations under the long-term power contracts as of June 30, 2016, are as follows:

Fixed Obligations			
Year	Transmission	Power	Total
2017	\$ 4,741	\$ 35,726	\$ 40,467
2018	4,741	35,726	40,467
2019	4,741	35,726	40,467
2020	4,741	29,497	34,238
2021	4,741	28,128	32,869
2022-2042	77,935	497,791	575,726
Total	<u>\$ 101,640</u>	<u>\$ 662,594</u>	<u>\$ 764,234</u>

The System has a contract with the Kings River Conservation District, which provides that the System receive all power generated by the Pine Flat Power Plant Project (the Project). Under the contract, the System is obligated to pay fixed amounts each year to cover the debt service on bonds issued by the District to build the Project, operations and maintenance expenses, and a charge for power supplied. Such payments are to be made until all of the bonds issued by the District to finance the Project have been retired in fiscal 2019. Payments to the District totaled approximately \$9.4 million and \$8.8 million during the years ended June 30, 2016, and 2015, respectively.

The amounts of the System's fixed obligations related to future principal and interest payments of the District's bonds as of June 30, 2016 are as follows:

Fixed Obligations	
Year	Total
2017	\$ 4,253
2018	4,239
2019	4,257
	\$ 12,749

DWR entered into a Power Agreement with the Northern California Power Agency (NCPA) and other project participants in fiscal 2014 to participate in the Lodi Energy Center Project (LEC Project). The terms of the agreement provide that DWR pay for 33.5 percent of the construction costs, as well as 33.5 percent of operating costs to receive 33.5 percent of the power output of the LEC Project on a long-term basis. Participation in the LEC Project assists DWR in meeting SWP energy requirements, including the replacement of a portion of the energy previously provided by the Reid Gardner Project. NCPA issued revenue bonds for DWR's share of the costs to construct the power plant in Lodi, California in fiscal 2011. The Lodi Energy Center is one of the most efficient thermal-generating units in California, and will be economically dispatched before other older gas-fired units, resulting in power revenues that are sufficient to cover the operational costs and a portion of DWR's debt service on the bonds.

The amounts of the System's fixed obligations related to future principal and interest payments of the LEC Project's bonds as of June 30, 2016 are as follows:

LEC Bonds Fixed Obligations	
Year	Total
2017	\$ 9,206
2018	9,208
2019	9,207
2020	9,209
2021	9,207
2022-2026	46,044
2027-2031	46,038
2032-2035	36,833
	\$ 174,952

Market value information for certain power purchases, sales and exchange contracts are disclosed at June 30, 2016, using forward market prices discounted at the prevailing risk-free interest rate. All ten sales contracts extending beyond June 30, 2016 expire in fiscal 2017. There are nineteen purchase contracts expiring in fiscal 2017, twelve purchase contracts will expire in fiscal 2018, and six purchase contracts will expire in fiscal 2019. The long-term energy purchase contracts involving energy delivered from the Pine Flat Power Plants and Solverde Solar will expire in fiscal 2037; Dominion Solar Holdings purchase contract will expire in fiscal 2035; two purchase contracts with the Metropolitan Water District of Southern California (Metropolitan), one of the Water Contractors, will expire in fiscal 2020 and 2021; and a purchase contract with Alameda Municipal Power will expire in fiscal 2017. An exchange agreement with the NCPA, operator of the Lodi Energy Center Project which commits DWR to purchase power on a long-term basis subject to the agreement, has no explicit termination date. Fair value of power purchase and sales commitments extending beyond June 30, 2016 are as follows:

Energy Commitments' Market Values

	<u>Number of Contracts</u>	<u>Total Capacity (MWh)</u>	<u>Fair Value at June 30, 2016</u>
Energy sales	10	325	\$ 308
Energy purchases	37	1,050	(21,142)
Long-term energy purchases	7	467	<u>(103,718)</u>
Total			<u>\$ (124,552)</u>

Contingencies

Litigation and Claims

Monterey Amendment

In 1994, the System and certain Water Contractors adopted a set of principles pursuant to which additional amendments to the Water Supply Contracts have since been negotiated (Monterey Amendment). The Monterey Amendment includes provisions related to the transfer of land and related assets, known as the Kern Water Bank, to the Kern County Water Agency (KCWA) (one of the Water Contractors), the operation of certain System reservoirs, transfers of water allocations between Water Contractors, establishment of certain operating reserves, and the revision of calculating certain Water Contractor billings. The Monterey Amendment has been executed by the System and 27 of the 29 Water Contractors, who receive approximately 99% of water delivered annually and who pay approximately 99% of annual water supply revenues. Certain parties have disputed the Monterey Amendment by challenging the validity of the related Environmental Impact Report (EIR). While the courts have allowed the System to proceed with the implementation of the Monterey Amendment, the System was required to prepare a new EIR. DWR completed the new Final EIR in February 2010 and filed its Notice of Determination in May 2010. In June 2010, two Delta water agencies and several environmental organizations and individuals

filed a lawsuit in Sacramento Superior Court challenging DWR's California Environmental Quality Act (CEQA) compliance and the validity of the Monterey Amendment, including DWR's transfer of the Kern Fan Element to the KCWA. In July 2010, the same plaintiffs in the Sacramento Superior Court case filed a lawsuit in Kern County Superior Court challenging the transfer of the Kern Fan Element from KCWA to the Kern Water Bank Authority, a local joint powers agency which now has responsibility for the management of the Kern Fan Element and Kern Water Bank. In addition, in June 2010, two water districts in Kern County filed a separate lawsuit in Kern County Superior Court, primarily challenging DWR's CEQA compliance with respect to the Kern Fan Element transfer from DWR to KCWA. The two lawsuits filed in Kern County Superior Court were transferred to the Sacramento Superior Court. In December 2012, DWR prevailed on its challenge to the plaintiffs' validation causes of action (including the validity of the Kern Fan Element transfer) on the grounds that they were not filed timely. This left only the plaintiffs' CEQA compliance challenge. After holding a hearing on the CEQA challenges in the remaining two cases, the trial court ruled that most of the EIR was adequate under CEQA, but that the EIR's discussion of impacts on continued use and operation of the Kern Water Bank was insufficient. The court therefore issued a decision in favor of the plaintiffs in the two cases finding that the EIR failed to analyze impacts associated with the use and operation of the Kern Water Bank, particularly as to potential groundwater and water quality impacts. In October 2014, the Court ordered DWR, as the remedy for the deficiency, to provide additional environmental analysis on the future impacts of the continued use and operation of the Kern Water Bank and upon completion of the EIR process, to determine whether to continue the use and operation of the Kern Water Bank. DWR released the Draft Revised EIR on the Kern Water Bank for public comment in April 2016 and expects to release the Final Revised EIR in the fall of 2016. In December 2014, one set of plaintiffs filed a notice of appeal with the Court of Appeal. The plaintiffs are appealing the lower court's final CEQA and validation decisions. The System; however, does not believe that there will be any material adverse impact on the System's financial position or results from operations, even if these lawsuits are successful.

Other Claims by Water Contractors, Including Claims Concerning Charges for Recreation and Fish and Wildlife Enhancement

In accordance with the Water Supply Contracts, in December 2005, 27 Water Contractors and entities representing Water Contractors filed "Notices of Contest" with the System challenging the accuracy of various charges in the System's billings. One Water Contractor also filed a claim based on its Notice of Contest with the Victim Compensation and Government Claims Board. The System has been reviewing these Notices of Contest and investigating the items raised.

One item that has been determined to have merit, contested the System's practice of charging the Water Contractors for certain financing costs of the recreation and fish and wildlife enhancement portion of facilities financed with Water System Revenue Bonds. The System rectified the situation by restating past bills to provide appropriate credits back to the Water Contractors for the contested charges and taking other actions to pay for the costs of the recreation and fish and wildlife enhancement portion of System facilities with sources other than charges to the Water Contractors. Such actions included DWR entering into Tolling and Waiver Agreements in 2007 and 2008 with the 27 Water Contractors that signed the Monterey Amendment, which included certain waivers allowing DWR to resume issuing revenue bonds in May 2008. The sale of System Revenue Bonds had been suspended pending the resolution of the recreation and fish and wildlife enhancement issue.

In addition to waivers included in the 2007 and 2008 Tolling and Waiver Agreements, which helped to facilitate the resumption of the sale of System Revenue Bonds, the Tolling and Waiver Agreements, as amended, also tolled (i.e. suspended) until December 31, 2017 the running of the time period and statute of limitations for filing by the Water Contractors of (1) protests regarding the System's bills to the Water Contractors for the years 2007 through 2016, (2) claims arising from the System's revisions to prior year invoices that were made to adjust for improper charges to the Water Contractors for recreation and fish and wildlife enhancement costs, and (3) certain other specified claims. The Tolling and Waiver Agreements also tolled the running of the time period for bringing an action on the Victim Compensation and Government Claims Board claim regarding the 2006 invoice that was filed by one of the Water Contractors. In the meantime, the System and Water Contractors are continuing their efforts to resolve issues that are covered by the Tolling and Waiver Agreement. However, no assurance can be given that the Water Contractors will not file additional Notices of Contest, claims and/or lawsuits with respect to the issues under discussion once the Tolling and Waiver Agreements expire.

General

The System, during the ordinary course of its operations, has been named in a number of additional suits and claims, several of which are still pending.

In the opinions of management and the System's Legal Counsel, such legal actions will not have a material effect on the System's financial position or changes in financial position. If incurred, such costs would be recoverable from project beneficiaries under the Water Supply Contracts.

Federal Energy Regulatory Commission Proceedings

There are a number of proceedings pending before the Federal Energy Regulatory Commission (FERC) that may impact the cost of System operations. Some of these proceedings address requests from the California Independent System Operator (CAISO), investor-owned utilities, and others to increase or adjust rates or allocate responsibility for costs for transmission and other services provided to the System and other entities in California. The System is participating in these proceedings, since the outcome of these proceedings has the potential to increase the System's annual power costs. However, the System does not believe that any increased charges arising from these proceedings will materially impact the System's financial position or changes in financial position. Any increased charges will be passed through to the Water Contractors under the Water Supply Contracts in the form of higher operations charges.

Pollution Remediation

Pollution remediation obligations are recorded by the System when one or more of the GASB Statement No. 49 obligating events have occurred and when a reasonable estimate of the remediation cost is available. These liabilities are measured using actual contract costs, where no change in cost is expected, or the engineering estimated contract costs. The remediation obligation estimates that appear in this report are subject to change over time. Costs may vary due to price fluctuations, changes in technology, changes in potential responsible parties, results of environmental studies, changes to statutes or regulations, and other factors that could result in revisions to these estimates. Prospective recoveries from responsible parties may reduce the System's obligation.

The System recognized Pollution Remediation Liabilities of \$4.2 million in current portion and \$44.8 million in long-term portion totaling \$49 million at June 30, 2016. This liability is comprised of two components. There are two identified locations of required pollution remediation, previously owned, Reid Gardner Unit 4 in Nevada and the Methyl Mercury Control programs in the Delta. In addition, the total liability for pollution remediation includes the GHG emissions credits to be surrendered to California Air Resources Board (CARB). The following table shows pollution remediation liability for the years ended June 30, 2016 and 2015:

Pollution Remediation Liabilities		
	2016	2015
Current liabilities:		
Reid Gardner Power Plant	\$ 2,000	\$ 3,500
Delta Mercury Control Program	1,285	1,288
Green House Gas Emissions Credits	922	5,457
Total current liabilities	\$ 4,207	\$ 10,245
Long-term liabilities:		
Reid Gardner Power Plant	\$ 24,300	\$ 25,600
Delta Mercury Control Program	5,025	5,120
Green House Gas Emissions Credits	15,529	2,859
Total Long-term liabilities	\$ 44,854	\$ 33,579

Reid Gardner Power Plant

The Reid Gardner (RG) Power Plant, located near Moapa, Nevada, is operated by Nevada Energy (NVE) and consists of four coal-powered generators—Units 1 through 4. DWR's ownership interest in Unit 4 of the Reid Gardner coal plant terminated in 2013, but the remediation costs described below are being shared under an Environmental Agreement also executed between NVE and DWR in 2013.

In February 2008, NVE entered into an Administrative Order on Consent (AOC) with the Nevada Division of Environmental Protection (NDEP). Pursuant to the AOC, NVE agreed to undertake investigatory activities into various potential areas of contamination at RG and also to ultimately remediate groundwater, soils and other contamination at the RG facility, or mitigate adverse impacts. Groundwater and soils have been affected by certain constituents of concern associated with flue gas desulfurization effluent settlement in evaporation ponds. Since some of this contamination can be associated with the Unit No. 4 generation related facilities, such as the Unit 4 evaporation ponds, DWR, as prior co-owner of Unit No. 4, has agreed to share the cost of NVE's investigatory activities, which may ultimately lead to the remediation measures prescribed by NDEP to NVE. These activities are projected to continue through at least 2032.

During calendar year 2014, NVE provided DWR their projected schedule and budget by source area based on ongoing and planned investigations and overall AOC planning activities. Using NVE's projections and applying DWR's agreed upon cost sharing

percentages in the Environmental Agreement, DWR's estimated equitable share of the current value of outlays is \$26.3 million. The System expended approximately \$2.8 million in fiscal 2016 and DWR expects to pay \$2 million of the total estimated financial liability during fiscal 2017. The total remediation outlay estimate is expected to be refined, and adjusted accordingly, as additional site assessment and final remediation disposition information becomes available.

Delta Mercury Control Program

In June 2011, the State Water Resources Control Board (SWRCB) adopted an amendment to the Sacramento-San Joaquin Delta Basin Plan regarding the control in the Delta of methyl mercury. The amendment, among other things, assigns certain responsibilities jointly to DWR (with regard to both the System and DWR's flood management programs), the Central Valley Flood Protection Board and the State Lands Commission to reduce methyl mercury in the open waters of the Delta. In addition, DWR and others are assigned certain responsibilities regarding the discharge of methyl mercury from wetland and other aquatic restoration and enhancement projects.

DWR's mercury program was created to address its obligations under the Delta Mercury Control Program. The System's estimated value of remediation outlays remaining for this program is \$6.3 million. The System has expended approximately \$4.1 million through June 30, 2016. DWR estimates that the System will incur costs of approximately \$1.3 million in fiscal 2017 and estimates remaining long-term costs through 2020 at approximately \$5 million.

The State Water Resources Control Board (SWRCB) is currently developing a statewide mercury regulation applicable to inland waters, including reservoirs. Draft regulatory language and associated environmental analysis is currently expected to be released in 2016, with adoption by the SWRCB in 2017. Once promulgated, DWR will be responsible for meeting fish tissue and or water quality objectives statewide in DWR reservoirs identified by the regulation. Currently, nine DWR reservoirs have been identified by the SWRCB for regulation. These include Oroville, San Luis, Castaic, and Pyramid. There is insufficient information available to enable DWR to estimate the timing, magnitude or the System's share of potential compliance costs, if any, at this time.

Green House Gas Emissions Credits

The System is required to report and recognize the liability related to certain vintage years of the LEC Project under AB32. Each year the GHG allowances held in UPIS as an Intangible Asset, are evaluated and reported by the Power and Risk Analysis Office to CARB to be charged as pollution remediation expenses and a liability is recognized. The System's market analysis value of total compliance instruments to be surrendered is \$16.4 million. The System surrendered \$6.9 million of compliance instruments during fiscal 2016 under this program. The System expects to surrender approximately \$922 thousand due in November of fiscal 2017 and estimates remaining long-term portion at approximately \$15.5 million.

11. Self-Insurance

The System is self-insured for all completed facilities of the SWP. The System is also self-insured for workers' compensation, general liability and other risks. All workers' compensation claims and other losses are on a pay-as-you-go basis. The Water Supply Contracts provide for recovery of such losses from the Water Contractors. Additionally, the CVP act and the related bond resolutions authorize the issuance of additional bonds, payable from available revenues or federal reimbursements under the National Disaster Act, for the purpose of providing funds for emergency repairs to power projects or water system projects necessitated by natural disasters, provided that certain conditions are met.

DWR has purchased automobile insurance for its fleet of vehicles through the California Department of General Services, Office of Risk & Insurance Management, and certain amounts are assessed to the System while some amounts may be directly charged for those vehicles owned specifically by the System.

12. Economic Dependency

The System's water supply revenue is generally derived from the 29 Water Contractors. The highest percentage of water supply revenues came from the Metropolitan Water District of Southern California. The following table shows total water supply revenues billed to Water Contractors including cover, refunds, and adjustments that exceeded 5% of the total water supply revenues sold by the System.

Water Supply Revenues				
	2016	% Total	2015	% Total
The Metropolitan Water District	\$ 586,992	53.72%	\$ 493,380	53.49%
Kern County Water Agency	110,799	10.14%	95,398	10.34%
Coachella Valley Water District	54,676	5.01%	-	-

The System sold power to 9 power companies for both fiscal years ended June 30, 2016 and 2015. The highest percentage of power revenues came from the CAISO. The following table shows power sales to companies which exceeded 5% of the total power sold by the System excluding power sold to the Water Contractors in the amount of \$520 and \$2.7 million, for the years ended June 30, 2016 and 2015, respectively.

Power Sales				
	2016	% Total	2015	% Total
California Independent System Operator	\$ 52,597	73.83%	\$ 61,759	69.59%
Northern California Power Agency	13,143	18.45%	24,502	27.61%

Similarly, the System purchased power from 16 and 17 power suppliers during the years ended June 30, 2016 and 2015, respectively. The highest percentage of power provided to the System came from the CAISO. The following table shows power purchases from suppliers which exceeded 5% of the total power purchased by the System.

Power Purchases				
	<u>2016</u>	<u>% Total</u>	<u>2015</u>	<u>% Total</u>
California Independent System Operator	\$ 105,356	47.89%	\$ 95,827	47.70%
Northern California Power Agency	32,724	14.88%	42,178	20.99%
Morgan Stanley Capital Group Inc.	31,748	14.43%	34,907	17.38%

13. Segment Information

The table below presents the condensed statements of net position, the statements of revenues, expenses and changes in net position and the statements of cash flows for the System's two segments, as of and for the years ended June 30, 2016 and 2015.

Segment	2016			2015 (As restated)		
	Activities Allowed Under			Activities Allowed Under		
	Burns-Porter Act	Central Valley Project Act	Total	Burns-Porter Act	Central Valley Project Act	Total
Condensed Statements of Net Position:						
Assets						
Current assets	\$ 386,990	\$ 328,711	\$ 715,701	\$ 274,012	\$ 367,148	\$ 641,160
Other assets	1,187,719	365,321	1,553,040	1,308,557	394,718	1,703,275
Capital assets	803,230	2,896,093	3,699,323	821,616	2,711,066	3,532,682
Total assets	2,377,939	3,590,125	5,968,064	2,404,185	3,472,932	5,877,117
Deferred outflows of resources	56,533	173,698	230,231	38,045	181,281	219,326
Total assets and deferred outflows of resources	\$ 2,434,472	\$ 3,763,823	\$ 6,198,295	\$ 2,442,230	\$ 3,654,213	\$ 6,096,443
Liabilities						
Current liabilities	\$ 153,042	\$ 307,671	\$ 460,713	\$ 148,904	\$ 276,524	\$ 425,428
Long-term liabilities	788,039	2,811,012	3,599,051	752,867	2,797,968	3,550,835
Total liabilities	941,081	3,118,683	4,059,764	901,771	3,074,492	3,976,263
Deferred inflows of resources	284,135	648,968	933,103	331,203	583,549	914,752
Total liabilities and deferred inflows of resources	1,225,216	3,767,651	4,992,867	1,232,974	3,658,041	4,891,015
Net position:						
Net investment in capital assets	831,288	324,199	1,155,487	929,050	236,203	1,165,253
Restricted	377,968	(328,027)	49,941	280,206	(240,031)	40,175
Total net position	1,209,256	(3,828)	1,205,428	1,209,256	(3,828)	1,205,428
Total liabilities, deferred inflows of resources, and net position	\$ 2,434,472	\$ 3,763,823	\$ 6,198,295	\$ 2,442,230	\$ 3,654,213	\$ 6,096,443
Condensed Statements of Revenues, Expenses and Changes in Net Position:						
Operating revenues:						
Water supply	\$ 692,999	\$ 255,106	\$ 948,105	\$ 657,639	\$ 225,899	\$ 883,538
Power sales	71,163	73	71,236	92,066	(286)	91,780
Federal and State reimbursements	29,396	37,913	67,309	16,669	27,391	44,060
	793,558	293,092	1,086,650	766,374	253,004	1,019,378
Depreciation expense	(21,939)	(55,231)	(77,170)	(21,680)	(59,815)	(81,495)
Other operating expense	(744,200)	(52,391)	(796,591)	(581,987)	(25,420)	(607,407)
Income from operations	27,419	185,470	212,889	162,707	167,769	330,476
Capital revenues recovered (deferred), net	(8,471)	(110,039)	(118,510)	(164,868)	(79,077)	(243,945)
Interest expense	(7,376)	(99,602)	(106,978)	(9,945)	(86,137)	(96,082)
Transfers In/(Out)	(13,241)	13,241	-	10,855	(10,855)	-
Other revenues (expenses), net	1,669	10,930	12,599	1,251	8,300	9,551
Increase (decrease) in net position	-	-	-	-	-	-
Net position, beginning of year	1,209,256	(3,828)	1,205,428	1,209,256	(3,828)	1,205,428
Net position, end of year	\$ 1,209,256	\$ (3,828)	\$ 1,205,428	\$ 1,209,256	\$ (3,828)	\$ 1,205,428
Condensed Statements of Cash Flows:						
Net cash provided by (used in):						
Operating activities	\$ 173,755	\$ 277,640	\$ 451,395	\$ 60,676	\$ 173,183	\$ 233,859
Capital and related financing activities	(94,170)	(310,666)	(404,836)	13,107	(214,790)	(201,683)
Investing activities	2,212	16,834	19,046	1,689	5,873	7,562
Net (decrease) increase in cash and cash equivalents	81,797	(16,192)	65,605	75,472	(35,734)	39,738
Cash and equivalents, beginning of year	230,925	370,099	601,024	155,453	405,833	561,286
Cash and equivalents, end of year	\$ 312,722	\$ 353,907	\$ 666,629	\$ 230,925	\$ 370,099	\$ 601,024

14. New Governmental Accounting Standards

GASB Statement No. 68

In January 2016, after the California State Auditor issued their unmodified opinion on the reports related to the GASB Statement No 68, the State Controller communicated to State Departments that the original allocations and GASB 68 accounting elements that were provided to each entity on August 5, 2015 had been adjusted. Each entity was given the option of either restating their fiscal year 2014-15 financial statements or to account for those adjustments to the allocation in the current 2015-16 fiscal year. The System chose to incorporate the allocation adjustments in the current fiscal year.

GASB Statement No. 72

In February 2015, the GASB issued Statement No. 72, *Fair Value Measurement and Application*. This Statement addresses accounting and financial reporting issues related to fair value measurements. The definition of *fair value* is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The requirements of GASB No. 72 are effective for fiscal year 2016 and thereafter. The System holds investments that are measured at fair value on a recurring basis. The financial statement items in connection with GASB No. 72 are presented in this fiscal year financial statements.

GASB Statement No. 73

In June 2015, the GASB issued Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*. The objective of this Statement is to improve the usefulness of information about pensions included in the general purpose external financial reports of state and local governments for making decisions and assessing accountability. The requirements of GASB No. 73 are effective for fiscal year 2016 and thereafter. It has been determined that GASB No. 73 did not impact the System.

GASB Statement No. 74

In June 2015, the GASB issued Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. The objective of this Statement is to improve the usefulness of information about postemployment benefits other than pensions (other postemployment benefits or OPEB) included in the general purpose external financial reports of state and local governmental OBEP plans for making decisions and assessing accountability. The requirements of GASB No. 74 are effective for fiscal year 2017 and thereafter. The System is currently evaluating the impact this statement will have on its financial statements.

GASB Statement No. 75

In June 2015, the GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pension*. The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for postemployment benefits other than pensions (other postemployment benefits or OPEB). It also improves information provided by state and local governmental employers about financial support for OPEB that is provided by other entities. The requirements of GASB No. 75 are effective for fiscal year 2018 and thereafter.

GASB Statement No. 76

In June 2015, the GASB issued Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. The objective of this Statement is to identify—in the context of the current governmental financial reporting environment—the hierarchy of generally accepted accounting principles (GAAP). The “GAAP hierarchy” consists of the sources of accounting principles used to prepare financial statements of state and local governmental entities in conformity with GAAP and the framework for selecting those principles. The requirements of GASB No. 76 are effective for fiscal year 2016 and thereafter. It has been determined that GASB No. 76 did not have a material effect on the System’s financial statement.

GASB Statement No. 77

In August 2015, the GASB issued Statement No. 77, *Tax Abatement Disclosures*. Financial statements prepared by state and local governments in conformity with generally accepted accounting principles provide citizens and taxpayers, legislative and oversight bodies, municipal bond analysts, and others with information they need to evaluate the financial health of governments, make decisions, and assess accountability. The requirements of GASB No. 77 are effective for fiscal 2016 and thereafter. It has been determined that GASB No. 77 did not impact the System.

GASB Statement No. 78

In December 2015, the GASB issued Statement No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*. The objective of this Statement is to address a practice issue regarding the scope and applicability of Statement No. 68, *Accounting and Financial Reporting for Pensions*. This issue is associated with pensions provided through certain multiple-employer defined benefit pension plans and to state or local government employers whose employees are provided with such pensions. The requirements of GASB No. 78 are effective for fiscal 2016 and thereafter. It has been determined that GASB No. 78 did not impact the System.

GASB Statement No. 79

In December 2015, the GASB issued Statement No. 79, *Certain External Investment Pools and Pool Participants*. This Statement addresses accounting and financial reporting for certain external investment pools and pool participants. Specifically, it establishes criteria for an external investment pool to qualify for making the election to measure all of its investments at amortized cost for financial reporting purposes. The requirements of GASB No. 79 are effective for fiscal 2016 and thereafter. It has been determined that GASB No. 79 did not impact the System.

GASB Statement No. 80

In January 2016, the GASB issued Statement No. 80, *Blending Requirements for Certain Component Units—an amendment of GASB Statement No. 14*. The objective of this Statement is to improve financial reporting by clarifying the financial statement presentation requirements for certain component units. This Statement amends the blending requirements established in paragraph 53 of Statement No. 14, *The Financial Reporting Entity, as amended*. The requirements of GASB No. 80 are effective for fiscal 2016 and thereafter. It has been determined that GASB No. 80 did not impact the System.

GASB Statement No. 81

In March 2016, the GASB issued Statement No. 81, *Irrevocable Split-Interest Agreements*. The objective of this Statement is to improve accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement. The requirements of GASB No. 81 are effective for fiscal year 2017 and thereafter. The System is currently evaluating the impact this statement will have on its financial statements.

GASB Statement No. 82

In March 2016, the GASB issued Statement No. 82, *Pension Issues—an amendment of GASB Statements No. 67, No. 68, and No. 73*. The objective of this Statement is to address certain issues that have been raised with respect to Statements No. 67, *Financial Reporting for Pension Plans*, No. 68, *Accounting and Financial Reporting for Pensions*, and No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*. The requirements of GASB No. 82 are effective for fiscal 2016 and thereafter. It has been determined that GASB No. 82 did not impact the System.

15. Subsequent Events

On October 20, 2016, the System issued tax-exempt CVP Revenue Bonds, Series AW, with a par amount of \$428.1 million and \$93.5 million premium. The average yield on the bonds is 2.71%. The bond proceeds of \$521.2, combined with the System's cash contribution of \$1.3 million will be used to redeem \$96 million of Commercial Paper Notes Series 1, refund \$97.4 million of outstanding bonds, and deposit \$267 million in the construction account to fund new projects. Bond proceeds will also be used to fund the debt service reserve account, pay capitalized interest, and cover costs of issuance. The System expects to achieve a net present value savings of \$7 million representing 7.15% of the refunded bonds.



REQUIRED SUPPLEMENTARY INFORMATION

Schedule of the System's Proportionate Share of the Net Pension Liability

Last 10 Years* (in thousands)

	2016	2015
The System's proportion of the net pension liability	1.7191%	1.6927%
The System's proportionate share of the net pension liability	\$ 485,502	\$ 426,935
The System's covered-employee payroll	\$ 181,151	\$ 164,571
The System's proportionate share of the net pension liability as a percentage of their covered-employee payroll	268.01%	259.42%
Plan fiduciary net position as a percentage of the total pension liability	70.68%	73.05%

Notes to Schedule:

Changes of benefit terms:

In 2016, the figures above do not include any liability impact that may have resulted from plan changes which occurred after the June 30, 2014 valuation date. This applies for voluntary benefit changes as well as any offers of Two Years Additional Service Credit (a.k.a. Golden Handshakes).

* - Fiscal year 2016 was the 2nd year of implementation, therefore only two years are shown.

Schedule of the System's Contributions

Last 10 Years* (in thousands)

	2016	2015
Contractually required contribution	\$ 47,978	\$ 44,393
Contributions in relation to the contractually required contribution	47,978	44,393
Contribution deficiency (excess)	\$ -	\$ -
Fund's covered-employee payroll	\$ 181,151	\$ 164,571
Contributions as a percentage of covered-employee payroll	26.49%	26.97%

Notes to Schedule:

The actuarial methods and assumptions used to determine contribution rates for year ended June 30, 2016 was from the June 30, 2014 Valuation Date.

Actuarial Cost Method	Entry Age Normal
Actuarial Assumptions:	
Inflation	2.75%
Salary Increases	Varies by Entry Age and Service
Payroll Growth	3.00%
Investment Rate of Return	7.65% Net of Pension Plan Investment Expenses; includes Inflation.
Retirement Age	The probabilities of Retirement are based on the 2014 CalPERS Experience Study for the period from 1997 to 2011.
Mortality	The probabilities of mortality rates are based on the 2014 CalPERS Experience Study for the period from 1997 to 2011. Pre-retirement and Post-retirement mortality rates include 20 years of projected mortality improvement using Scale BB published by the Society of Actuaries.

* - Fiscal year 2016 was the 2nd year of implementation, therefore only two years are shown.



SUPPLEMENTARY INFORMATION

Calculation of Adequacy of Debt Service Coverage for the Central Valley Project Revenue Bonds

Debt Service Coverage	<i>(amounts in thousands)</i>	
	2016	2015
Water supply revenues, Central Valley Project Act	\$ 255,106	\$ 225,899
Add: Cover Collected as Proceeds Due To Water Contractors	57,779	54,316
Less: Devil Canyon Castaic Revenues	(19,646)	(18,171)
Revenues not available for Debt Service	(8,679)	(8,234)
Net CVP revenues available for debt service	284,560	253,810
Principal and interest for revenue bonds	\$ 227,350	\$ 192,924
Debt service coverage	125.2%	131.6%

Note: Section 805 of the general bond resolution for the Central Valley Project (CVP) Water System Revenue Bonds states, "The total amount of Revenues receivable under all Water Supply Contracts in any Year shall be the sum of (A) 1.25 times the Annual Debt Service for such Year to be paid from the Revenue Fund, plus (B) the amount estimated by DWR, pursuant to Section 605, to be required from the Revenue Fund in such Year to provide for Water System Operating Expenses..."

The Supplementary Information, Calculation of Adequacy of Debt Service Coverage, for the Central Valley Project (CVP) Revenue Bonds is based on \$255.1 million in fiscal 2016 and \$225.9 million in fiscal 2015, respectively in Water Supply Revenues of the System's (CVP) segment.

In fiscal 2016, the revenues include: an increase of \$57.8 million in refundable proceeds, a decrease of \$19.6 million for principal and interest payments for the Devil Canyon Castaic Facilities Bonds (DCC) since the DCC General Bond resolution does not require cover to be collected for these bonds, and a decrease of \$8.7 million in miscellaneous revenue not available for debt service.

In fiscal 2015, the revenues include: an increase of \$54.3 million in refundable proceeds, a decrease of \$18.2 million for principal and interest payments for the DCC Facilities bonds, and a decrease of \$8.2 million in revenue not available for debt service of which \$5.4 million are amounts to be refunded to the Water Contractors and \$2.8 million related to operations and maintenance.

STATISTICAL SECTION



STATISTICAL SECTION

This part of the California State Water Resources Development System's comprehensive annual financial report presents detailed information as a context for understanding what the information in the financial statements and note disclosures say about the government's overall financial health.

<u>Contents</u>	<u>Page</u>
Financial Trends	86
<i>These schedules contain trend information to help the reader understand how the System's financial performance and well-being have changed over time.</i>	
Revenue Capacity	89
<i>These schedules contain information to help the reader access the System's two most significant local revenue sources, water supply and power sales.</i>	
Debt Capacity	93
<i>These schedules present information to help the reader access the affordability of the System's current levels of outstanding debt and the System's ability to issue additional debt in the future.</i>	
Demographic and Economic Information	95
<i>These schedules offer demographic and economic indicators to help the reader understand the environment within which the System's financial activities take place.</i>	
Operating Information	97
<i>These schedules contain service and infrastructure data to help the reader understand how the information in the System's financial report relates to the services the System provides and the activities it performs.</i>	

Statements of Revenues, Expenses and Changes in Net Position (Unaudited)

Last Ten Fiscal Years (in thousands)

	2007	2008	2009	2010
OPERATING REVENUES:				
Water supply	\$ 704,921	\$ 752,853	\$ 721,253	\$ 853,158
Power sales	222,206	215,430	175,318	165,664
Federal and State reimbursements	24,463	20,992	18,266	24,021
Total operating revenues	951,590	989,275	914,837	1,042,843
OPERATING EXPENSES:				
Operations and maintenance	344,464	409,150	466,708	435,801
Purchased power	374,568	323,236	206,632	212,658
Depreciation and amortization expense	78,065	79,136	79,632	80,813
Operating expenses recovered (deferred), net	(24,972)	40,976	21,257	189,000
Total operating expense	772,125	852,498	774,229	918,272
NET OPERATING INCOME (LOSS)	179,465	136,777	140,608	124,571
NONOPERATING REVENUES (EXPENSES):				
Capital revenues recovered (deferred), net	4,377	(20,595)	44,344	19,823
Interest expense	(151,746)	(156,716)	(131,481)	(151,390)
Other revenues (expenses), net	(32,096)	40,534	(53,471)	6,996
Total nonoperating revenues (expenses)	(179,465)	(136,777)	(140,608)	(124,571)
CHANGE IN NET POSITION	\$ -	\$ -	\$ -	\$ -

Source: State Water Resources Development System

Statements of Revenues, Expenses and Changes in Net Position (Unaudited)

Last Ten Fiscal Years (in thousands)

2011	2012	2013	2014	2015	2016
\$ 874,748	\$ 860,891	\$ 931,808	\$ 789,370	\$ 883,538	\$ 948,105
193,154	148,360	146,277	131,952	91,780	71,236
28,294	36,561	52,397	52,186	44,060	67,309
1,096,196	1,045,812	1,130,482	973,508	1,019,378	1,086,650
428,559	526,402	545,413	557,209	404,627	511,926
342,446	271,377	258,899	241,444	202,780	219,661
100,257	87,400	85,236	68,896	81,495	77,170
118,325	67,063	22,261	-	-	65,004
989,587	952,242	911,809	867,549	688,902	873,761
106,609	93,570	218,673	105,959	330,476	212,889
22,812	43,834	(174,356)	(42,934)	(243,945)	(118,510)
(134,996)	(107,770)	(53,492)	(115,499)	(96,082)	(106,978)
5,575	(29,634)	9,175	52,474	9,551	12,599
(106,609)	(93,570)	(218,673)	(105,959)	(330,476)	(212,889)
\$ -					

Source: State Water Resources Development System

Net Position by Component (Unaudited)

Last Ten Fiscal Years (in thousands)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
NET POSITION										
Net investment in capital assets	\$ 98,490	\$ 127,858	\$ 381,106	\$ 486,347	\$ 554,854	\$ 684,025	\$ 832,147	\$ 994,561	\$ 1,165,263	\$ 1,155,487
Restricted	1,106,941	1,077,573	824,325	719,084	650,574	521,403	373,281	210,867	40,175	49,941
TOTAL NET POSITION	\$ 1,205,431	\$ 1,205,431	\$ 1,205,431	\$ 1,205,431	\$ 1,205,428					

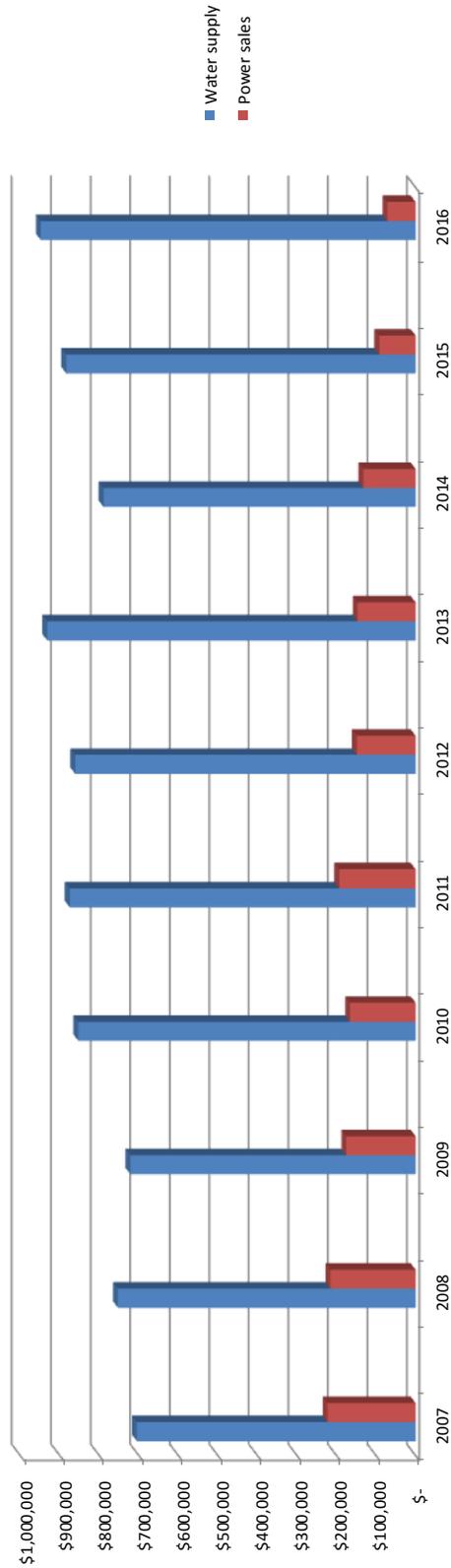
Source: State Water Resources Development System

Significant Revenues By Source (Unaudited)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Last Ten Fiscal Years (in thousands)										
Operating Revenues by Source										
Water supply	\$ 704,921	\$ 752,853	\$ 721,253	\$ 853,158	\$ 874,748	\$ 860,891	\$ 931,808	\$ 789,370	\$ 883,538	\$ 948,105
Power sales	222,206	215,430	175,318	165,664	193,154	148,360	146,277	131,952	91,780	71,236
TOTAL	\$ 927,127	\$ 968,283	\$ 896,571	\$ 1,018,822	\$ 1,067,902	\$ 1,009,251	\$ 1,078,085	\$ 921,322	\$ 975,318	\$ 1,019,341

Source: State Water Resources Development System

Operating Revenues by Source



Summary of Schedule of Water and Power Sales Rates (Unaudited)

Last Ten Years

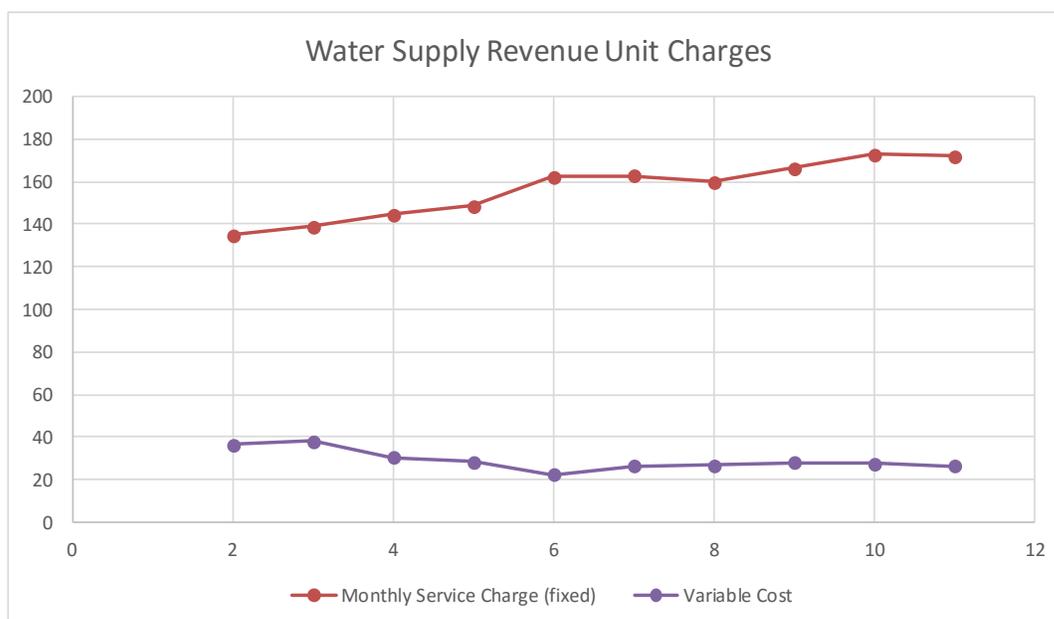
Financial Statement Year	Calendar Year	Water Supply ^a	
		Monthly Service Charge (fixed)	Variable Cost
2007	2006	\$ 134.82	\$ 36.43
2008	2007	138.71	38.19
2009	2008	144.41	30.53
2010	2009	148.49	28.33
2011	2010	162.20	22.45
2012	2011	162.64	26.36
2013	2012	159.89	26.79
2014	2013	166.37	28.21
2015	2014 ^c	172.81	27.52
2016	2015 ^c	171.99	26.34

Source: State Water Project Analysis Office Bulletin 132-xx Table B-24

a) Hypothetical charges, which, if assessed on all Table A of Bulletin 132 water delivered to date, all surplus water delivered prior to May 1, 1973, and all Table A water estimated to be delivered during the remainder of the project repayment period (Table B-5B of Bulletin 132), would provide a sum at the end of the period financially equivalent to all Transportation Charge and Delta Water Charge payments required under a water supply contract, considering interest at the Project Interest Rate, 4.610 percent per annum.

b) Numbers reflect amounts on a Calendar Year basis

c) Amounts for these years are preliminary and subject to change



Largest Distribution Water Revenue Accounts (Unaudited)

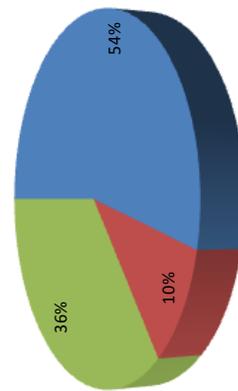
Current Year and Nine Years Prior

Customer	FY 2016			FY 2017		
	Annual Water Sales	Rank	Percentage of Total ^a	Annual Water Sales	Rank	Percentage of Total ^a
THE METROPOLITAN WATER DISTRICT	\$ 511,976,442	1	54%	\$ 430,001,810	1	61%
KERN COUNTY WA - AG	94,810,452	2	10%	56,393,680	2	8%
Subtotal	<u>\$ 606,786,894</u>		<u>64%</u>	<u>\$ 486,395,490</u>		<u>69%</u>
Total Water Consumption	<u>\$ 948,104,522</u>			<u>\$ 704,921,000</u>		

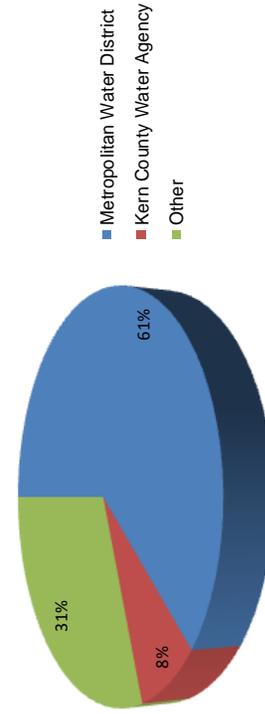
Source: State Water Resources Development System

a) Percentage of total is based on total revenues billed under the water supply contracts

FY 2016



FY 2017



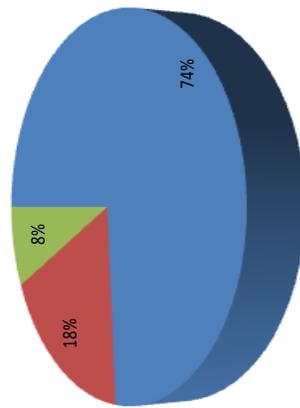
Largest Distribution Power Sales Revenue Accounts (Unaudited)

Current Year and Nine Years Prior

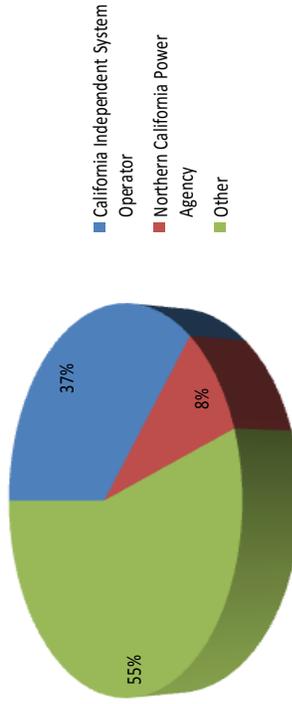
Customer	FY 2016			FY 2017		
	Annual Revenues	Rank	Percentage of Total	Annual Revenues	Rank	Percentage of Total
CALIFORNIA INDEPENDENT SYSTEM OPERATOR	\$ 52,597,411	1	74%	\$ 81,403,067	1	37%
NORTHERN CALIFORNIA POWER AGENCY	13,143,096	2	18%	18,684,041	2	8%
Subtotal	<u>\$ 65,740,507</u>		<u>92%</u>	<u>\$100,087,108</u>		<u>45%</u>
Total Power Sales	<u>\$ 71,236,463</u>			<u>\$222,205,762</u>		

Source: State Water Resources Development System

FY 2016



FY 2017



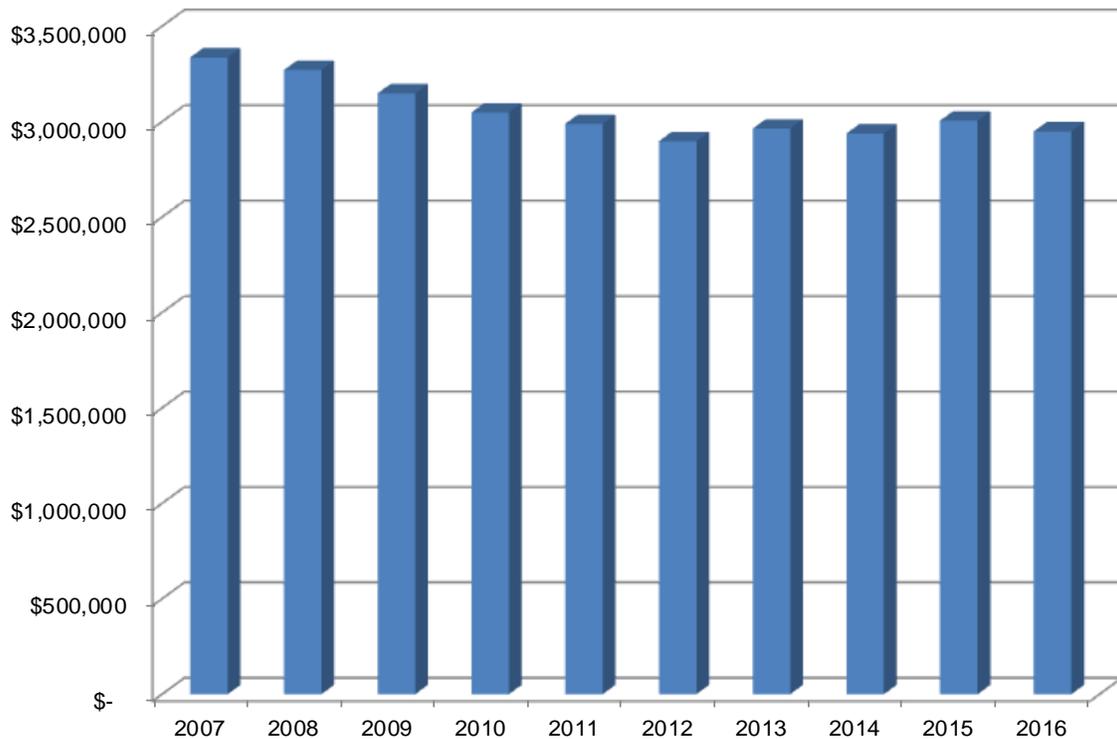
Ratios of Outstanding Debt by Type (Unaudited)

Last Ten Fiscal Years (in thousands)

Fiscal Year	Revenue Bonds	General Obligation Bonds	Commercial Paper	PMIA Loan	Total
2007	\$ 2,568,083	\$ 634,750	\$ 133,362	\$ -	\$ 3,336,195
2008	2,636,769	584,395	19,352	29,600	3,270,116
2009	2,579,158	531,700	9,897	27,288	3,148,043
2010	2,500,049	476,915	46,473	23,912	3,047,349
2011	2,491,854	420,540	54,578	21,055	2,988,027
2012	2,487,737	362,375	28,783	18,052	2,896,947
2013	2,594,459	302,920	50,505	14,896	2,962,780
2014	2,647,814	241,835	36,136	11,579	2,937,364
2015	2,724,008	184,960	87,900	8,094	3,004,962
2016	2,770,888	135,045	42,776	-	2,948,709

Source: State Water Resources Development System

Outstanding Debt



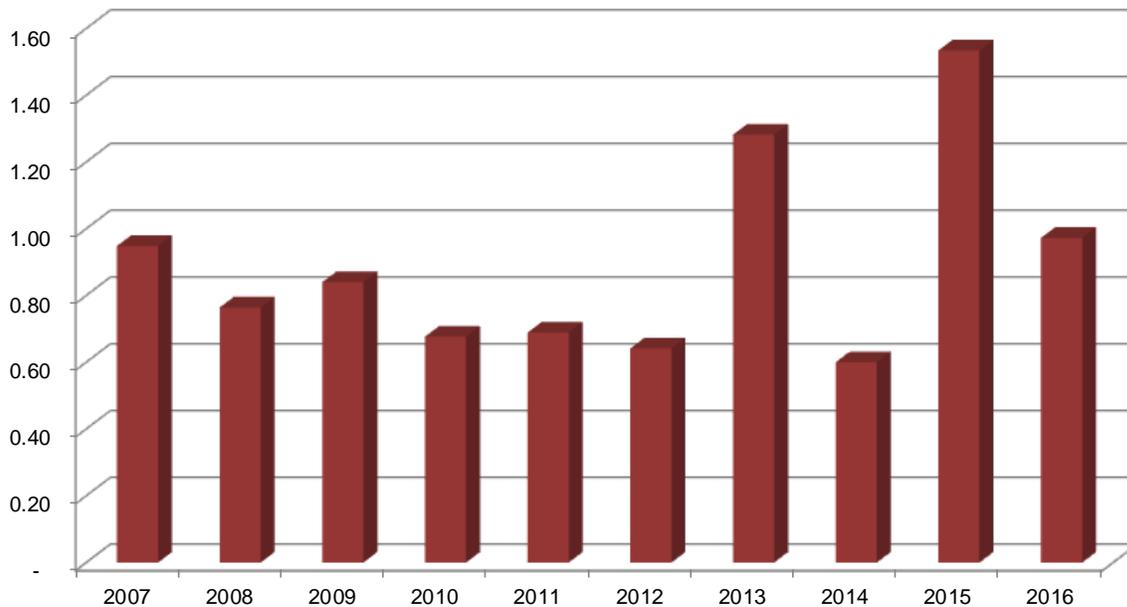
Pledged Revenue Coverage (Unaudited)

Last Ten Fiscal Years (in thousands)

Fiscal Year	Gross Revenue	Operating Expenses	Net Revenue Available for Debt Service	Debt Service Requirements			Coverage
				Principal	Interest	Total	
2007	\$ 951,590	\$ 694,060	\$ 257,530	\$ 119,825	\$ 151,746	\$ 271,571	0.95
2008	989,275	773,362	215,913	125,890	156,716	282,606	0.76
2009	914,837	694,597	220,240	130,730	131,481	262,211	0.84
2010	1,042,843	837,459	205,384	152,144	151,390	303,534	0.68
2011	1,096,196	889,330	206,866	165,245	134,996	300,241	0.69
2012	1,045,812	864,842	180,970	174,315	107,770	282,085	0.64
2013	1,130,482	826,573	303,909	183,610	53,492	237,102	1.28
2014	973,508	798,653	174,855	175,860	115,499	291,359	0.60
2015	1,019,378	607,407	411,971	172,455	96,082	268,537	1.53
2016	1,086,650	796,591	290,059	185,815	112,345	298,160	0.97

Source: State Water Resources Development System

Debt Coverage Ratio



Demographic and Economic Information (Unaudited)

Last Ten Years

<u>Year</u>	<u>Population (in thousands)</u>	<u>Personal Income (in millions)</u>	<u>Per Capita Personal Income</u>	<u>Unemployment Rate</u>
2006	36,247	\$ 1,501,831	\$ 41,693	4.9%
2007	36,553	1,565,343	43,182	5.3%
2008	36,856	1,602,749	43,786	7.2%
2009	37,077	1,537,136	41,588	11.3%
2010	37,339	1,583,447	42,399	12.1%
2011	37,679	1,691,003	44,844	11.7%
2012	38,044	1,812,315	47,600	10.4%
2013	38,375	1,849,505	48,115	8.9%
2014	38,737	1,939,528	49,976	7.5%
2015	39,093	2,061,149	52,644	6.2%

1 - Source: Economic Research Unit, California Department of Finance

2 - Note: 2016 information is not available and therefore not presented

California Number of Employees By Industry (Unaudited)

	2006	2007	2008	2009	2010
Agriculture, Forestry, Fishing, Hunting	437,617	444,478	459,723	434,275	440,265
Mining	24,723	25,282	26,698	23,244	25,011
Utilities	56,978	58,276	58,575	60,288	57,175
Construction	957,256	900,386	782,432	601,982	562,922
Manufacturing	1,512,772	1,464,136	1,425,225	1,261,582	1,250,589
Wholesale Trade	706,834	719,608	705,036	636,330	647,193
Retail Trade	1,672,636	1,673,198	1,615,574	1,495,711	1,496,821
Transportation and Warehousing	425,350	434,105	432,622	396,512	397,932
Information	467,757	476,419	472,152	436,865	429,065
Finance and Insurance	641,764	607,118	563,136	528,813	509,852
Real Estate and Rental and Leasing	291,700	282,800	274,778	250,908	248,452
Services	6,077,509	6,200,250	6,232,695	5,947,240	6,063,638
Nonclassifiable Establishments (3)	29,514	56,682	73,151	72,563	44,336
Federal, State and Local Government	2,336,653	2,404,511	2,405,547	2,352,014	2,302,160
Total for all Industries	15,639,063	15,747,249	15,527,344	14,498,327	14,475,411

	2011	2012	2013	2014	2015
Agriculture, Forestry, Fishing, Hunting	449,614	463,476	463,169	467,923	471,566
Mining	27,016	28,475	27,986	29,142	25,668
Utilities	58,199	59,160	58,240	57,829	57,577
Construction	580,550	609,365	656,000	691,811	748,872
Manufacturing	1,257,097	1,264,017	1,265,860	1,283,779	1,303,651
Wholesale Trade	661,757	679,339	702,319	713,642	719,576
Retail Trade	1,522,619	1,553,812	1,587,467	1,615,557	1,645,332
Transportation and Warehousing	404,582	415,488	433,112	455,070	488,428
Information	425,193	426,056	445,121	459,781	486,838
Finance and Insurance	512,160	522,529	520,579	514,826	523,933
Real Estate and Rental and Leasing	247,476	253,154	260,584	265,335	271,617
Services	6,216,242	6,519,084	6,809,757	7,056,066	7,247,138
Nonclassifiable Establishments (3)	58,663	59,443	36,808	63,478	102,851
Federal, State and Local Government	2,276,153	2,260,320	2,276,164	2,317,813	2,388,336
Total for all Industries	14,697,321	15,113,718	15,543,166	15,992,052	16,481,383

(1) Source: California Employment Development Department

(2) The industry data provided are intended to provide similar alternative information regarding the concentration of employment in various sectors of the California Economy. Due to confidentiality issues, the names of the top individual employers are not available.

(3) Note: Businesses are designated as "Nonclassifiable Establishments" when there is insufficient information to determine the appropriate industry classification.

(4) Note: 2016 information is not available and therefore not presented

Definitions of Terms and Source Notes: www.labormarketinfo.edd.ca.gov

Number of Employees (Unaudited)

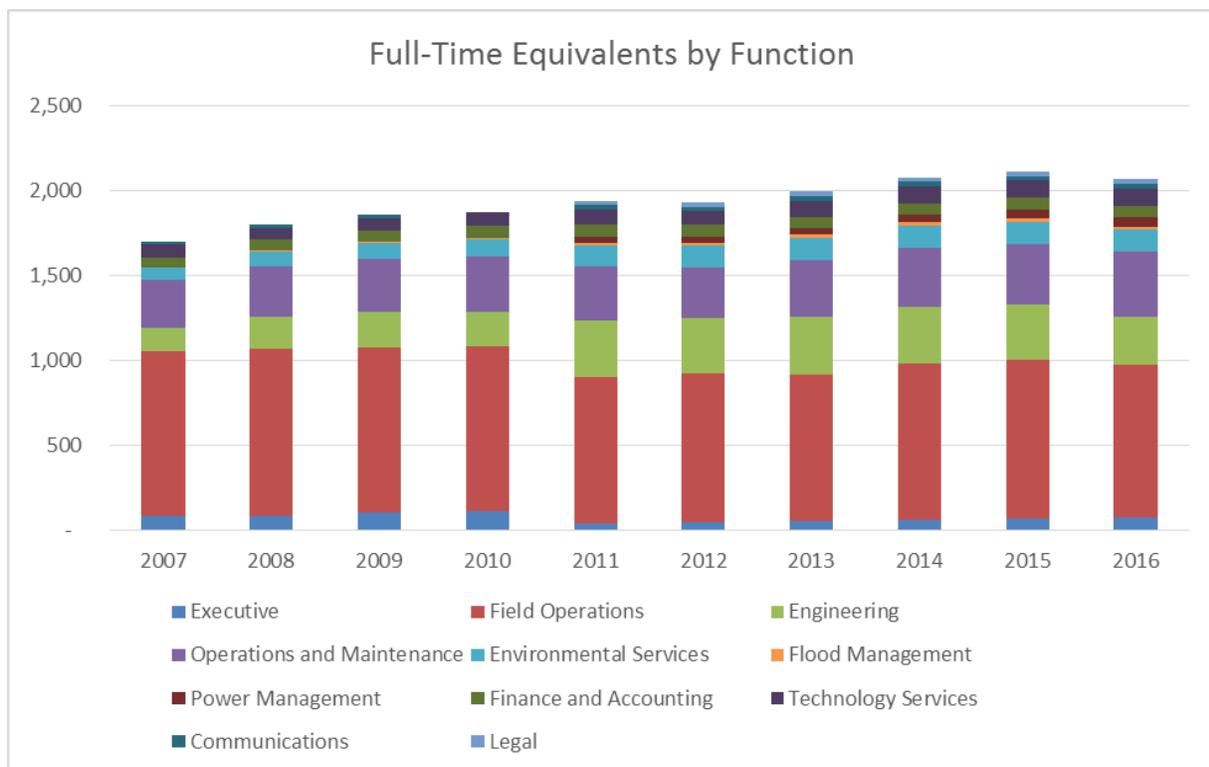
Last Ten Fiscal Years

Full-Time Equivalents

Function	Full-Time Equivalents as of June 30, ¹									
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Executive	83	88	109	117	42	49	55	61	69	75
Field Operations	972	983	965	964	863	872	864	920	935	899
Engineering	140	189	210	207	330	331	338	332	326	281
Operations and Maintenance	277	293	312	321	318	294	337	346	354	386
Environmental Services	75	87	95	103	124	129	130	137	133	130
Flood Management	3	7	8	8	16	18	17	17	17	16
Power Management					38	38	35	47	52	53
Finance and Accounting	58	64	66	71	66	69	69	66	72	66
Technology Services	74	70	74	78	91	76	96	101	102	104
Communications	17	17	17		27	25	26	23	26	27
Legal					25	28	27	27	29	29
Grand Total	1,699	1,798	1,856	1,869	1,940	1,929	1,993	2,078	2,113	2,066

1 - Excludes Retired Annuitants; FTEs calculated using the most recently available allocation factors

Source: California Department of Water Resources



Operating and Capital Indicators (Unaudited)

Last Ten Years

	2006	2007	2008	2009	2010	2011	2012	2013	2014 ^a	2015 ^a
Water										
Water Deliveries (AF)	4,837,034	4,300,681	3,174,228	3,164,327	3,695,808	4,711,558	4,009,663	3,371,000	1,992,157	2,104,264
Percentage of Requested Water Delivered	65%	60%	35%	40%	50%	80%	65%	35%	5%	20%
Gross Area Served (Acres)	25,024,175	25,063,045	25,063,586	25,091,434	25,091,780	25,091,780	23,509,885	23,847,530	23,527,540	23,514,148
Estimated Population Served ³	25,967,312	26,041,804	26,314,962	26,216,435	21,462,843	26,324,019	26,201,400	26,267,499	26,520,624	26,876,859
Statewide Precipitation (% of Avg) ¹	136%	65%	78%	81%	108%	135%	77%	79%	56	74
Statewide Snowpack (% of Apr 1 Avg)	161%	58%	100+%	88%	n/a	165%	54%	47%	33	5
Statewide River Runoff (% of Avg) ¹	170%	53%	60%	65%	91%	146%	62%	60%	35	45
Total Storage (% of Maximum) ²	82%	50%	38%	39%	52%	85%	56%	41%	43	30
Total Miles of Aqueducts	705	705	705	705	705	705	705	705	705	705
Number of Storage Facilities	20	20	20	20	20	20	20	20	20	20
Gross Storage Capacity (AF)	6,761,600	6,761,600	6,761,600	6,761,600	6,761,600	6,761,600	6,761,600	6,761,600	6,761,600	6,761,600
Number of Pumping Plants	23	23	23	23	23	23	23	23	23	23
Number of Pumps	162	162	162	162	162	162	162	162	162	162
Power										
Energy Generated (Mwh)	7,056,000	5,577,000	3,541,000	3,650,000	3,920,000	4,846,000	4,198,000	3,068,539	1,132,659	1,274,706
Energy Purchased (Mwh)	5,811,000	6,642,000	4,603,000	3,970,000	5,081,000	4,895,000	3,741,000	3,604,135	1,691,424	2,780,643
Energy Sold (Mwh)	3,709,000	2,446,000	2,399,000	1,530,000	1,814,000	1,192,000	533,000	936,975	33,000	566,891
Net Power Consumption (Mwh)	9,158,000	9,773,000	5,745,000	6,090,000	7,187,000	8,549,000	7,406,000	5,735,699	2,791,083	3,488,458
Number of Power Plants	10	10	10	10	10	10	10	10	9	9
Number of Power Generating Units	37	37	37	37	37	37	37	37	36	36

Note: Unless otherwise noted, amounts are reported on a calendar year basis.

Source: State Water Project Analysis Office Annual Bulletin 132

1 - Measured in Water Years, which run from October of the prior year to September of the reported year

2 - Measured at the end of the Water Year

3 - Contains duplicate values. Some areas that are in two or more Contractor areas are included in each Contractor's total.

a - Amounts for these years are preliminary and subject to change

Legend

AF - Acre Feet

Mwh - Megawatt Hours

Capital Assets, Net (in thousands) (Unaudited)

	Last Ten Fiscal Years				
	2007	2008	2009	2010	2011
Nondepreciable Utility Plant					
Land	\$ 137,353	\$ 137,353	\$ 138,156	\$ 136,129	\$ 136,129
Construction work in progress	253,152	365,297	461,208	400,229	366,975
Land use rights	-	-	10,925	10,925	11,005
Other intangible assets	-	-	80,659	81,976	81,976
Total Nondepreciable Utility Plant	390,504	502,649	690,948	629,259	596,085
Depreciable Utility Plant					
Aqueducts	1,949,071	1,949,071	1,949,071	2,029,898	2,057,437
Dams & reservoirs	765,246	765,246	765,246	765,246	781,110
Power plants	845,977	845,977	845,977	909,904	910,100
Pumping plants	784,247	784,247	784,247	784,247	787,008
Environmental preservation and mitigation	67,797	67,797	67,797	67,797	67,797
Fish protection	33,934	33,934	33,934	33,934	33,934
Facilities	-	-	-	-	64,810
Equipment	55,427	58,246	62,487	65,580	67,996
Computer software	-	-	23,629	23,629	23,629
Land use rights	-	-	-	-	-
Other intangible assets	-	-	-	-	-
General	-	-	-	-	5,964
Total Depreciable Utility Plant	4,501,699	4,504,517	4,532,388	4,680,235	4,799,785
Less Accumulated Depreciation/Amortization	(1,854,541)	(1,932,412)	(2,015,610)	(2,094,306)	(2,194,406)
Total Utility Plant, Net	\$ 3,037,662	\$ 3,074,755	\$ 3,207,726	\$ 3,215,188	\$ 3,201,464

Source: State Water Resources Development System

Capital Assets, Net (in thousands) (Unaudited)

	Last Ten Fiscal Years				
	2012	2013	2014	2015	2016
Nondepreciable Utility Plant					
Land	\$ 136,129	\$ 136,797	\$ 137,033	\$ 141,874	\$ 147,681
Construction work in progress	408,072	528,836	438,244	611,900	769,871
Land use rights	11,250	11,549	11,583	11,630	11,760
Other intangible assets	88,930	100,064	103,740	103,445	100,123
Total Nondepreciable Utility Plant	644,381	777,246	690,600	868,849	1,029,435
Depreciable Utility Plant					
Aqueducts	2,064,208	2,071,255	2,167,237	2,169,352	2,171,981
Dams & reservoirs	781,202	781,408	781,408	708,303	708,303
Power plants	906,554	911,703	466,358	441,202	470,818
Pumping plants	829,344	836,655	836,814	826,704	838,880
Environmental preservation and mitigation	67,797	67,797	67,797	67,797	67,797
Fish protection	33,934	33,934	33,934	33,934	35,544
Facilities	65,820	66,230	246,397	254,741	271,965
Equipment	70,593	71,819	75,705	77,384	79,229
Computer software	24,162	24,501	24,529	24,531	24,717
Land use rights	272	272	272	272	272
Other intangible assets	-	11,995	11,995	12,005	12,005
General	6,491	39,579	61,310	62,262	73,053
Total Depreciable Utility Plant	4,850,377	4,917,148	4,773,756	4,678,487	4,754,564
Less Accumulated Depreciation/Amortization	(2,281,806)	(2,366,429)	(1,994,695)	(2,014,654)	(2,084,676)
Total Utility Plant, Net	\$ 3,212,952	\$ 3,327,965	\$ 3,469,661	\$ 3,532,682	\$ 3,699,323

Source: State Water Resources Development System



Edmund G. Brown Jr.
Governor,
State of California

John Laird
Secretary of Resources,
Natural Resources Agency

Mark Cowin
Director,
Department of Water Resources



APPENDIX B

PROPOSED FORM OF OPINION OF NOTE COUNSEL

The following form of opinion is expected to be delivered with respect to the Series 1 Notes on May 4, 2017.

_____, 2017

State of California Department of Water Resources
Sacramento, California

State of California Department of Water Resources
Water Revenue Commercial Paper Notes
Series 1

(Final Opinion)

We have acted as note counsel to the State of California Department of Water Resources (the “Department”) in connection with authorization of issuance of up to \$300,000,000 aggregate principal amount (at any time Outstanding) of commercial paper notes by the Department pursuant to and by authority of Part 3 of Division 6 of the Water Code of the State of California, and under a resolution of the Department, adopted as of March 1, 1993, as amended (the “Resolution”) and designated State of California Department of Water Resources Water Revenue Commercial Paper Notes, Series 1 (the “Notes of Series 1”). Capitalized terms not otherwise defined herein shall have the meanings ascribed thereto in the Resolution.

In such connection, we have reviewed the Resolution, the Issuing and Paying Agent Agreement, the Tax Certificate of the Department dated the date hereof (the “Tax Certificate”), an opinion of counsel to the Department, certifications of the Department, the Treasurer of the State of California, the Issuing and Paying Agent and others as to certain factual matters and such other documents and matters as we deemed necessary to render the opinions set forth herein.

The opinions expressed herein are based on an analysis of existing laws, regulations, rulings and court decisions and cover certain matters not directly addressed by such authorities. Such opinions may be affected by actions taken or events occurring after the date hereof and before or after Notes of Series 1 are issued. We have not undertaken to determine, or to inform any person, whether any such actions or events are taken or omitted or events do occur or any other matters come to our attention after the date hereof. Accordingly, this letter speaks only as of its date and is not intended to, and may not, be relied upon in connection with any such actions, events or matters. We disclaim any obligation to update this letter. We have assumed the genuineness of all documents and signatures presented to us (whether as originals or as copies) and the due and legal execution and delivery thereof by, and the validity against, any parties other than the Department. We have assumed without undertaking to verify, the accuracy (as of the date hereof and as of the date of issuance from time to time of the Notes of Series 1) of the factual matters represented, warranted or certified in the documents, and of the legal conclusions contained in the opinion, referred to in the second paragraph hereof. Furthermore, we have assumed compliance with all covenants and agreements contained in the Resolution, the Issuing and Paying Agent Agreement and the Tax Certificate, including, without limitation, covenants and agreements compliance with which is necessary to assure that future actions, omissions or events will not cause interest on the Notes of Series 1

to be included in gross income for federal income tax purposes, possibly retroactive to the date on which the first Notes of Series 1 were issued. We call attention to the fact that the rights and obligations under the Notes of Series 1, the Resolution, the Issuing and Paying Agent Agreement and the Tax Certificate and their enforceability may be subject to bankruptcy, insolvency, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors' rights, to the application of equitable principles, to the exercise of judicial discretion in appropriate cases and to limitations on legal remedies against the State of California. We express no opinion with respect to any indemnification, contribution, liquidated damages, penalty (including any remedy deemed to constitute a penalty), right of set-off, arbitration, judicial reference, choice of law, choice of forum, choice of venue, non-exclusivity of remedies, waiver or severability provisions contained in the foregoing documents. Our services did not include financial or other non-legal advice. Finally, we undertake no responsibility for the accuracy, completeness or fairness of the Offering Memorandum or other offering material relating to the Notes of Series 1 and express no opinion with respect thereto.

Based on and subject to the foregoing, and in reliance thereon, as of the date hereof, we are of the following opinions:

1. The Resolution has been duly adopted by the Department and constitutes a valid and binding obligation of the Department in accordance with the terms of the Resolution.

2. The Notes of Series 1, when issued from time to time in the form authorized by and otherwise in compliance with the Resolution and authenticated by the Issuing and Paying Agent, in all respects in accordance with the Resolution and the Issuing and Paying Agent Agreement against payment therefor, will constitute valid and binding limited obligations of the Department, payable only out of the Revenues (as that term is defined in the Resolution) and moneys and securities held, and accounts established, under the Resolution.

3. The Notes of Series 1, when issued in the form authorized by the Resolution and authenticated by the Issuing and Paying Agent, in all respects in accordance with the Resolution and the Issuing and Paying Agent Agreement, will be secured by a first and direct charge and lien upon the Revenues and all moneys and securities held, and accounts established, under the Resolution (except amounts held in any Rebate Account established under the Resolution), subject only to the provisions of the Resolution permitting the payment or use of such Revenues, moneys, securities and accounts for the purposes, in the manner and upon the terms and conditions set forth in the Resolution. The Notes of Series 1 are not secured by any other property or moneys of the Department.

4. Neither the principal of nor the interest on the Notes of Series 1 constitutes a debt, liability or obligation of the State of California or, except as expressly provided in the Resolution, of the Department.

5. Interest on the Notes of Series 1, when the Notes of Series 1 are issued from time to time in accordance with the Resolution, the Issuing and Paying Agent Agreement and the Tax Certificate, will be excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986 and exempt from State of California personal income taxes. The amount treated as interest on the Series 1 Notes and excluded from gross income will depend upon the taxpayer's election under Internal Revenue Service Notice 94-84. Interest on the Series 1 Notes when issued from time to time in accordance with the Resolution, the Issuing and Paying Agent Agreement and the Tax Certificate, will not constitute a specific preference item for purposes of the federal individual or corporate alternative minimum taxes, although Note Counsel observes that such interest is included in adjusted current earnings when calculating corporate alternative minimum taxable income. Note Counsel

expresses no opinion regarding any other tax consequences related to the ownership or disposition of, or the amount, accrual or receipt of interest on, the Series 1 Notes.

Very truly yours,

ORRICK, HERRINGTON & SUTCLIFFE LLP

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