**THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA**

Basic Financial Statements

Three Months Ended September 30, 2020 and 2019

(Unaudited)

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UNAUDITED
September 30, 2020 and 2019

The following discussion and analysis of The Metropolitan Water District of Southern California's (Metropolitan) financial performance provides an overview of the financial activities for the three months ended September 30, 2020 and 2019. This discussion and analysis should be read in conjunction with the basic financial statements and accompanying notes, which follow this section.

## DESCRIPTION OF BASIC FINANCIAL STATEMENTS

Metropolitan maintains its accounting records in accordance with generally accepted accounting principles for enterprise fund (proprietary type fund) as prescribed by the Governmental Accounting Standards Board (GASB). The basic financial statements include statements of net position, statements of revenues, expenses and changes in net position, and statements of cash flows. The statements of net position include all of Metropolitan's assets, deferred outflows of resources, liabilities, and deferred inflows of resources, with the difference reported as net position, some of which is restricted in accordance with bond covenants or other commitments. The statements of revenues, expenses and changes in net position report all of Metropolitan's revenues and expenses during the periods indicated. The statements of cash flows show the amount of cash received and paid out for operating activities, as well as cash received from taxes and investment income, and cash used for construction projects, State Water Project costs and principal and interest payments on borrowed money. Certain amounts reported in fiscal year 2020 have been reclassified to conform to the fiscal year 2021 presentation. Such reclassification had no effect on the previously reported change in net position.

## CONDENSED FINANCIAL INFORMATION

*Condensed Schedule of Net Position*

| (Dollars in millions) | September 30, 2020 | 2019 | 2018 |
|---|---|---|---|
| **Assets and deferred outflows of resources** | | | |
| Capital assets, net | **$ 10,558.0** | $ 10,470.9 | $ 10,463.5 |
| Other assets | **2,036.7** | 1,941.1 | 1,991.9 |
| **Total assets** | **12,594.7** | 12,412.0 | 12,455.4 |
| Deferred outflows of resources | **162.6** | 184.6 | 237.4 |
| **Total assets and deferred outflows of resources** | **12,757.3** | 12,596.6 | 12,692.8 |
| **Liabilities and deferred inflows of resources** | | | |
| Long-term liabilities, net of current portion | **4,153.7** | 4,688.2 | 5,099.9 |
| Other liabilities | **1,519.8** | 945.7 | 723.4 |
| **Total liabilities** | **5,673.5** | 5,633.9 | 5,823.3 |
| Deferred inflows of resources | **68.6** | 31.5 | 46.6 |
| **Total liabilities and deferred inflows of resources** | **5,742.1** | 5,665.4 | 5,869.9 |
| **Net position** | | | |
| Net investment in capital assets, including State Water Project costs | **6,342.1** | 6,335.0 | 6,137.2 |
| Restricted | **511.3** | 457.3 | 404.2 |
| Unrestricted | **161.8** | 138.9 | 281.5 |
| **Total net position** | **$ 7,015.2** | $ 6,931.2 | $ 6,822.9 |

### Capital Assets, Net

Net capital assets include plant, participation rights, and construction work in progress, net of accumulated depreciation and amortization.

***First Quarter Fiscal 2021 Compared to First Quarter Fiscal 2020.*** At September 30, 2020, net capital assets totaled $10.6 billion, or 82.8 percent of total assets and deferred outflows of resources, and were $87.1 million higher than the prior year. The increase included Metropolitan's continued expenditures on the capital investment plan of $289.3 million (including $2.0 million of capitalized interest) and a net increase of $144.1 million in participation rights in State Water Project (SWP), offset by depreciation and amortization of $305.6 million and $40.7 million retirements of capital assets and write-off of construction in progress related to a recalculation of previously capitalized interest on construction. See the capital assets section on pages 15-16 for additional information.

***First Quarter Fiscal 2020 Compared to First Quarter Fiscal 2019.*** At September 30, 2019, net capital assets totaled $10.5 billion, or 83.1 percent of total assets and deferred outflows of resources, and were $7.4 million higher than the prior year. The increase included Metropolitan's continued expenditures on the capital investment plan of $240.2 million (including $2.0 million of capitalized interest) and a net increase of $145.8 million in participation rights in SWP and other facilities, offset by depreciation and amortization of $308.7 million and $69.9 million retirements of capital assets and write-off of construction in progress upon determination that no operating assets would result from the cost incurred. See the capital assets section on pages 15-16 for additional information

## Other Assets

Other assets include accounts receivable, inventories, prepaid costs, and cash and investments.

***First Quarter Fiscal 2021 Compared to First Quarter Fiscal 2020.*** At September 30, 2020, other assets totaled $2.0 billion and were $95.6 million higher than the prior year. The increase included $90.4 million higher cash and investments primarily due to $207.3 million proceeds from the Water Revenue Bonds 2020 Series A and $34.0 million refund of the California WaterFix (CWF) advance funding from the California Department of Water Resources (DWR) offset by $148.6 million principal payments on long-term debt.

***First Quarter Fiscal 2020 Compared to First Quarter Fiscal 2019.*** At September 30, 2019, other assets totaled $1.9 billion and were $50.8 million lower than the prior year. Cash and investments were $134.7 million lower, primarily due to $134.8 million principal payments on long-term debt. This decrease was offset by $65.8 million higher deposits, prepaid costs, and other primarily due to $41.5 million of prepaid costs related to the CWF advance funding agreement with DWR and an $11.4 million increase in Palos Verde Irrigation District land fallowing cost. In addition, inventory was $29.0 million higher due to an increase in water storage of 107.1 thousand acre feet (TAF).

## Deferred Outflows of Resources

Deferred outflows of resources include deferred outflows related to loss on bond refundings and swap terminations, deferred outflows related to the net pension liability and net OPEB liability, and deferred outflows for effective interest rate swaps.

***First Quarter Fiscal 2021 Compared to First Quarter Fiscal 2020.*** At September 30, 2020, deferred outflows totaled $162.6 million and were $22.0 million lower than the prior year. The decrease was primarily due to $21.7 million lower deferred outflows related to pension, which included $39.3 million lower deferred outflows due to changes of actuarial assumptions and $3.3 million lower deferred outflows related to the net difference between projected and actual earnings on pension plan investments, offset by $11.3 million higher difference between actual and expected experience and $9.6 million higher deferred outflows related to pension contributions subsequent to the measurement date. In addition, deferred loss on bond refundings was $8.3 million lower due to $4.3 million of scheduled amortization and $4.0 million of refunding transactions.

***First Quarter Fiscal 2020 Compared to First Quarter Fiscal 2019.*** At September 30, 2019, deferred outflows totaled $184.6 million and were $52.8 million lower than the prior year. The decrease was primarily due to $31.5 million lower deferred outflows related to pension, which included $39.3 million lower deferred outflows due to changes of actuarial assumptions and $16.4 million lower deferred outflows related to the net difference between projected and actual earnings on pension plan investments, offset by $25.1 million higher deferred outflows related to pension contributions subsequent to the measurement date. In addition, deferred loss on bond refundings was $14.3 million lower due to $8.7 million of refunding transactions and $5.6 million of scheduled amortization and deferred outflows related to loss on swap terminations was $8.9 million lower due to $6.2 million of refunding transactions and $2.7 million of scheduled amortization.

## Long-term Liabilities, Net of Current Portion

Long-term liabilities, net of current portion include long-term debt, revolving notes, customer deposits and trust funds, net pension liability, net OPEB liability, accrued compensated absences, workers' compensation and third party claims, fair value of interest rate swaps, and other long-term obligations.

***First Quarter Fiscal 2021 Compared to First Quarter Fiscal 2020.*** At September 30, 2020, long-term liabilities, net of current portion totaled $4.2 billion and were $534.5 million lower than the prior year primarily due to $526.2 million decrease in long-term debt, net of current portion, which included $597.7 million more current portion of long-term debt as compared to prior year, $148.6 million principal payments and $128.3 million of bond refundings, as the new debt issued was less than the amount of debt refunded, offset by $207.3 million in new revenue bonds and $141.1 million higher premiums and discounts. See other liabilities and long-term debt sections on pages 7 and 17, respectively, for additional information. Also contributing to the decrease in long-term liabilities, net of current portion was $56.9 million lower net OPEB liability primarily due to $50.1 million difference between expected and actual experience, $32.1 million of employer contributions to the OPEB plan and $16.2 million of OPEB plan investment earnings, offset by $31.6 million of interest on the total OPEB liability and $10.6 million of service costs. These decreases were offset by $35.0 million higher net pension liability primarily due to $168.1 million interest on the total pension liability and $35.7 million in service costs, offset by $114.2 million of pension plan investment earnings and $56.5 million employer contributions to the pension plan. Furthermore, fair value of interest rate swaps increased $5.6 million due to lower interest rates as compared to prior year.

***First Quarter Fiscal 2020 Compared to First Quarter Fiscal 2019.*** At September 30, 2019, long-term liabilities, net of current portion, totaled $4.7 billion and were $411.7 million lower than the prior year. The decrease in long-term debt, net of current portion of $423.9 million included $171.2 million of bond refundings, as the new debt issued was less than the amount of debt refunded, $134.8 million principal payments and $210.5 million more current portion of long-term debt as compared to prior year offset by $92.5 million higher premiums and discounts. See other liabilities and long-term debt sections on pages 7 and 17, respectively, for additional information. In addition, net pension liability was $26.9 million lower primarily due $139.0 million of pension plan investment earnings and employer contributions to the pension plan of $48.8 million offset by $161.0 million interest on the total pension liability. Net OPEB liability was also $13.0 million lower primarily due to $34.7 million of employer contributions to the OPEB plan and $18.5 million of OPEB plan investment earnings, offset by $30.3 million of interest on the total OPEB liability and $10.3 million of service costs. These decreases in long-term liabilities were offset by the $46.8 million Bank of America, N.A. notes issued for the CWF advance funding and $20.2 million higher fair value of interest rate swaps due to lower interest rates as compared to prior year.

## Other Liabilities

Other liabilities represent current liabilities that are due within one year. Current liabilities include accounts payable, accrued liabilities, and the current portion of long-term liabilities.

***First Quarter Fiscal 2021 Compared to First Quarter Fiscal 2020.*** At September 30, 2020, other liabilities totaled $1.5 billion and were $574.1 million higher than the prior year primarily due to $597.7 million more current portion of long-term debt primarily due to mandatory tender dates within one year for the outstanding Special Variable Rate Water Revenue Refunding Bonds, 2020 Series B in the amount of $271.8 million, the Subordinate Water Revenue Refunding Bonds, 2017 Series D and E in the amount of $191.2 million, and the Subordinate Water Revenue Bond 2016 Series A in the amount of $175.0 million. Further contributing to the increase in current portion of long-term debt is the Special Variable Rate Water Revenue Refunding Bonds 2018 Series A-1 and A-2 in the amount of $90.1 million and the Water Revenue Refunding Bonds 2016 Series B-1 and B-2 in the amount of $82.9 million, both of which are supported by standby bond purchase agreements (SBPA) that expire within one year. These increases are offset by the Water Revenue Bond 2000 Series B-3 in the amount of $78.9 million which is now supported by a SBPA that expires in March 2023 and the Water Revenue Refunding Bonds Series 2015 A-1 and A-2 which were refunded and reduced the current portion by $114.8 million. The increase in the current portion of long-term debt was offset by $40.9 million lower accounts payable and accrued expenses primarily due to lower SWP variable costs resulting from lower water allocation.

***First Quarter Fiscal 2020 Compared to First Quarter Fiscal 2019.*** At September 30, 2019, other liabilities totaled $945.7 million and were $222.3 million higher than the prior year primarily due to $210.5 million more current portion of long-term debt as the outstanding Water Revenue Bonds 2000 Series B-3 and 2017 Series A in the amount of $88.8 million and $80.0 million, respectively, were supported by a SBPA that expired in March 2020.

## Deferred Inflows of Resources

Deferred inflows of resources represent deferred inflows related to the net pension liability, net OPEB liability and deferred inflows for effective interest rate swaps.

***First Quarter Fiscal 2021 Compared to First Quarter Fiscal 2020.*** At September 30, 2020, deferred inflows of resources totaled $68.6 million and were $37.1 million higher than the prior year primarily due to a $40.0 million increase in deferred inflows related to OPEB which included $40.3 million higher differences between expected and actual experience. This increase was partially offset by $2.9 million lower deferred inflows related to pension which included $8.9 million lower differences between expected and actual experience and $4.8 million lower changes of assumptions offset by $10.8 million higher net difference between projected and actual earnings on pension plan investments.

***First Quarter Fiscal 2020 Compared to First Quarter Fiscal 2019.*** At September 30, 2019, deferred inflows of resources totaled $31.5 million and were $15.1 million lower than the prior year primarily due to a $21.9 million decrease in effective swaps due to lower interest rates, offset by $6.4 million higher deferred inflows related to pension which included $8.4 million higher changes of assumptions and $2.0 million lower difference between expected and actual experience.

## Net Investment in Capital Assets, including State Water Project Costs

Net investment in capital assets, including State Water Project costs, include amounts expended for capital improvements and SWP, offset by accumulated depreciation and outstanding debt issued for these purposes and related deferred outflows of resources.

***First Quarter Fiscal 2021 Compared to First Quarter Fiscal 2020.*** At September 30, 2020, net investment in capital assets, including State Water Project costs totaled $6.3 billion and was $7.1 million higher than the prior year. The increase included $87.1 million net increase in capital assets partially offset by $80.0 million increase in outstanding debt and related deferred outflows of resources. See discussions of these items in the capital assets and long-term debt sections on pages 15-16 and 17, respectively.

***First Quarter Fiscal 2020 Compared to First Quarter Fiscal 2019.*** At September 30, 2019, net investment in capital assets, including State Water Project costs totaled $6.3 billion and was $197.8 million higher than the prior year. The increase included $190.4 million decrease in outstanding debt and related deferred outflows of resources and $7.4 million net increase in capital assets. See discussions of these items in the capital assets and long-term debt sections on pages 15-16 and 17, respectively.

## Restricted Net Position

Restricted net position includes amounts restricted for debt service payments and operating expenses, both of which are required by bond covenants.

***First Quarter Fiscal 2021 Compared to First Quarter Fiscal 2020.*** At September 30, 2020, restricted net position totaled $511.3 million which was $54.0 million higher than prior year primarily due to $38.1 million increase in restricted for operating expenses as labor and benefit costs are estimated to be higher in fiscal year 2021 due to negotiated labor increases, higher pension contribution requirement and increase in benefit premiums and $15.9 million higher restricted for debt service resulting from higher principal and interest payment requirements.

***First Quarter Fiscal 2020 Compared to First Quarter Fiscal 2019.*** At September 30, 2019, restricted net position totaled $457.3 million which was $53.1 million higher than prior year primarily due to $34.0 million increase in restricted for operating expenses as the SWP operations, maintenance, power and replacement (OMP&R) costs are estimated to be higher in fiscal year 2020 and $19.1 million higher restricted for debt service resulting from higher principal and interest payment requirements.

## Unrestricted Net Position

Unrestricted net position consists of net position items that do not meet the definition of "restricted" or "net investment in capital assets, including State Water Project costs." Certain unrestricted net position items have been designated for purposes authorized by the Board.

***First Quarter Fiscal 2021 Compared to First Quarter Fiscal 2020.*** Unrestricted net position of $161.8 million at September 30, 2020, was $22.9 million higher than prior year which included changes in net position of $84.0 million for the twelve months ended September 30, 2020, offset by $54.0 million higher restricted for debt service and operating expenses and $7.1 million higher net investment in capital assets, including State Water Project costs.

***First Quarter Fiscal 2020 Compared to First Quarter Fiscal 2019.*** Unrestricted net position of $138.9 million at September 30, 2019, was $142.6 million lower than the prior year which included $197.8 million higher net investment in capital assets, including State Water Project costs and $53.1 million higher restricted for debt service and operating expenses partially offset by changes in net position before contributions of $108.3 million for the twelve months ended September 30, 2019.

## CHANGES IN NET POSITION

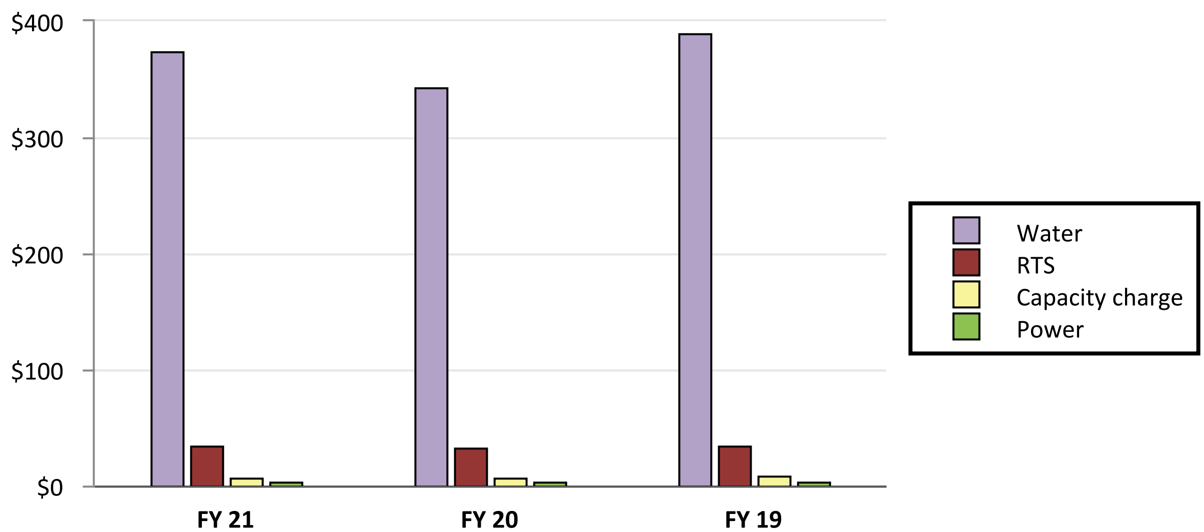
*Condensed Schedule of Revenues, Expenses, and Changes in Net Position*

| | Three Months Ended September 30, | | |
|---|---|---|---|
| (Dollars in millions) | **2020** | 2019 | 2018 |
| Water revenues | **$ 373.6** | $ 343.9 | $ 389.8 |
| Readiness-to-serve charges | **34.0** | 33.3 | 35.0 |
| Capacity charge | **7.6** | 7.6 | 8.9 |
| Power sales | **2.7** | 4.3 | 4.1 |
| **Operating revenues** | **417.9** | 389.1 | 437.8 |
| Taxes, net | **38.2** | 35.8 | 32.6 |
| Investment income, net | **1.8** | 6.0 | 3.7 |
| Other | **2.3** | 5.3 | 2.5 |
| **Nonoperating revenues** | **42.3** | 47.1 | 38.8 |
| **Total revenues** | **460.2** | 436.2 | 476.6 |
| | | | |
| Power and water costs | **(129.0)** | (107.5) | (110.7) |
| Operations and maintenance | **(133.1)** | (131.7) | (118.8) |
| Depreciation and amortization | **(86.3)** | (74.8) | (81.2) |
| **Operating expenses** | **(348.4)** | (314.0) | (310.7) |
| Bond interest, net of amount capitalized | **(22.6)** | (26.2) | (28.7) |
| Loss on disposal of plant assets | **(12.9)** | — | — |
| Other | **(0.6)** | (1.0) | (0.8) |
| **Nonoperating expenses** | **(36.1)** | (27.2) | (29.5) |
| **Total expenses** | **(384.5)** | (341.2) | (340.2) |
| | | | |
| **Changes in net position** | **75.7** | 95.0 | 136.4 |
| Net position at June 30, | **6,939.5** | 6,836.2 | 6,686.5 |
| **Net position at September 30,** | **$ 7,015.2** | $ 6,931.2 | $ 6,822.9 |

## Operating Revenues

Metropolitan's principal source of revenue is derived from the sale and availability of water, including water rates and other exchange and wheeling transactions, which typically account for approximately 85 percent of operating revenues. Metropolitan's primary sources of water supply are the Colorado River and the State Water Project.

**First Quarter**
**OPERATING REVENUES**
(Dollars in millions)




## Analytical Review of Operating Revenues

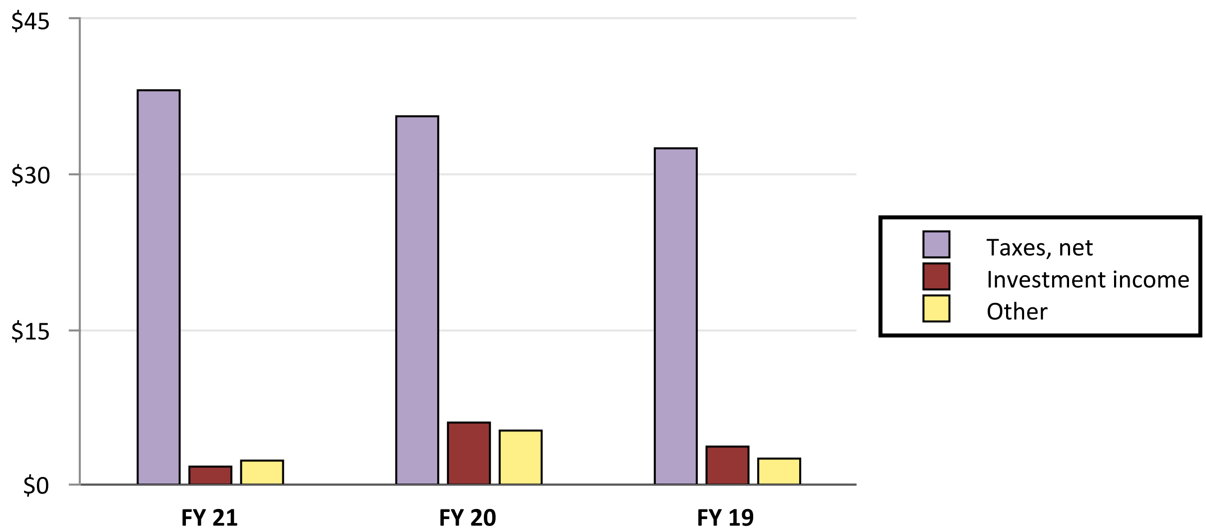
***First Quarter Fiscal 2021 Compared to First Quarter Fiscal 2020.*** For the three months ended September 30, 2020, operating revenues were $417.9 million or $28.8 million more than the prior year. The increase was primarily due to $29.7 million of higher water revenues, which included $20.5 million or 23.9 TAF of higher volumes sold and $9.2 million of higher price.

***First Quarter Fiscal 2020 Compared to First Quarter Fiscal 2019.*** For the three months ended September 30, 2019, operating revenues were $389.1 million or $48.7 million less than the prior year. The decrease was primarily due to $45.9 million of lower water revenues, which included $56.2 million or 67.6 TAF of lower volumes sold offset by $10.3 million of higher price.

## Nonoperating Revenues

The primary source of nonoperating revenues is property taxes.

**First Quarter**
**NONOPERATING REVENUES**
(Dollars in millions)




## Analytical Review of Nonoperating Revenues

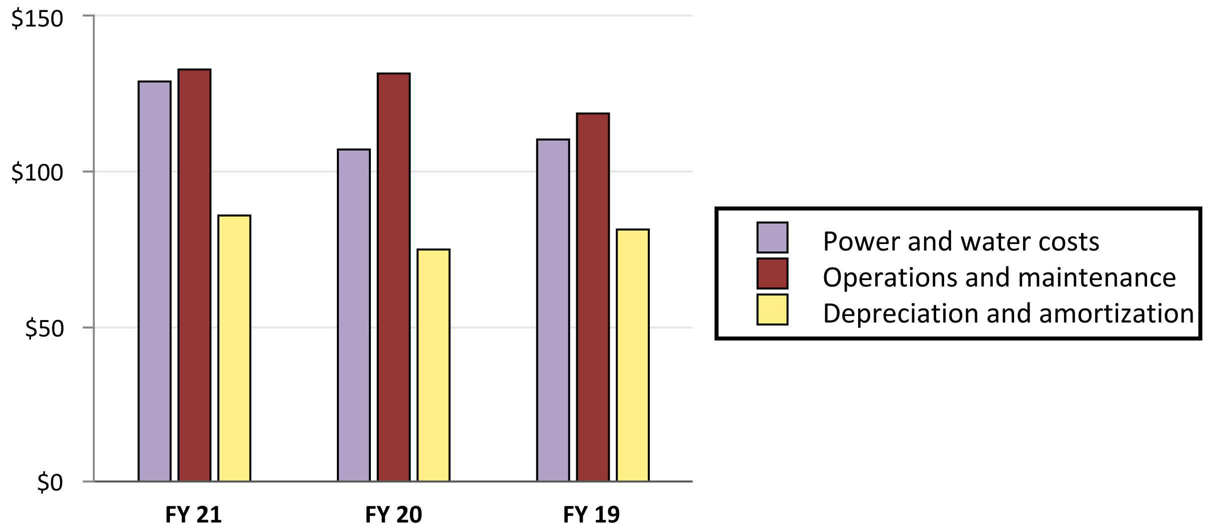
***First Quarter Fiscal 2021 Compared to First Quarter Fiscal 2020.*** Nonoperating revenues for the three months ended September 30, 2020, totaled $42.3 million and were $4.8 million lower than the prior year primarily due to $4.2 million lower investment income which included a $2.7 million unfavorable change in fair value of investments and $1.5 million lower rate of return.

***First Quarter Fiscal 2020 Compared to First Quarter Fiscal 2019.*** Nonoperating revenues for the three months ended September 30, 2019, totaled $47.1 million and were $8.3 million higher than the prior year. The increase included $3.2 million higher property tax revenue due to higher assessments resulting from increased property values. In addition, investment income increased $2.3 million, which included a $1.8 million favorable change in fair value of investments and $0.5 million higher rate of return.

## Operating Expenses

Operating expenses fall into three primary cost areas: power and water, operations and maintenance (O&M), and depreciation and amortization.

**First Quarter**
**OPERATING EXPENSES**
(Dollars in millions)




## Analytical Review of Operating Expenses

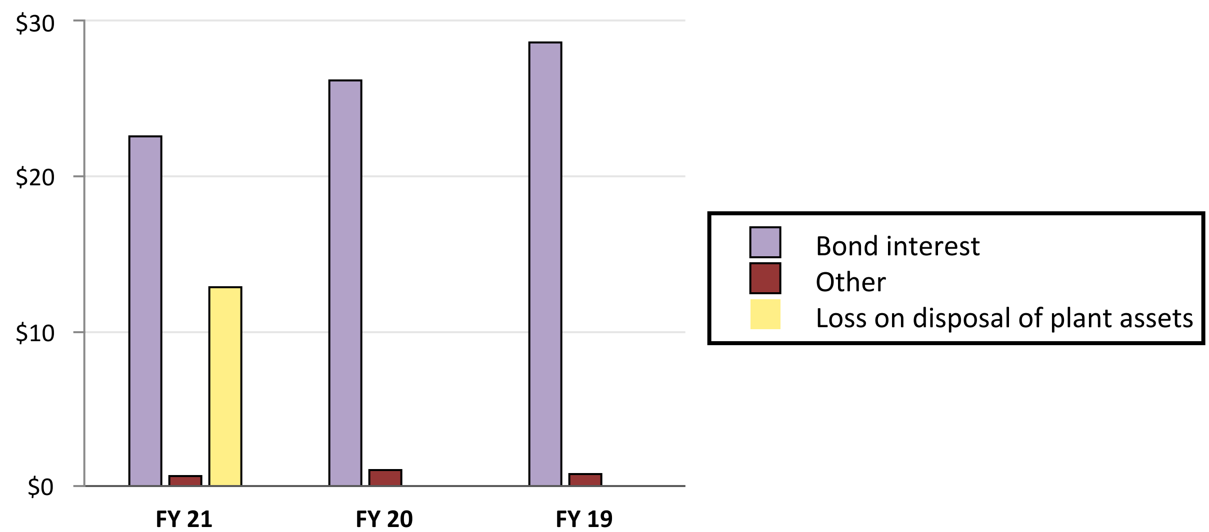
***First Quarter Fiscal 2021 Compared to First Quarter Fiscal 2020.*** For the three months ended September 30, 2020, operating expenses of $348.4 million were $34.4 million higher than the prior year. Power and water expenses increased $21.5 million due to an increase in the unit cost of water from prior year and depreciation and amortization expense increased $11.5 million due to a net increase in capital assets of $87.1 million.

***First Quarter Fiscal 2020 Compared to First Quarter Fiscal 2019.*** For the three months ended September 30, 2019, operating expenses of $314.0 million were $3.3 million more than prior year. O&M costs increased $12.9 million due to higher labor costs resulting from negotiations with bargaining units. This increase was offset by $6.4 million of lower depreciation and amortization and $3.2 million lower power and water expenses due to lower minimum SWP OMP&R costs related to an over collection of prior year's charges.

## Nonoperating Expenses

The primary sources of nonoperating expenses are interest expense on bonds, loss on disposal of plant assets and other.

**First Quarter**
**NONOPERATING EXPENSES**
(Dollars in millions)




## Analytical Review of Nonoperating Expenses

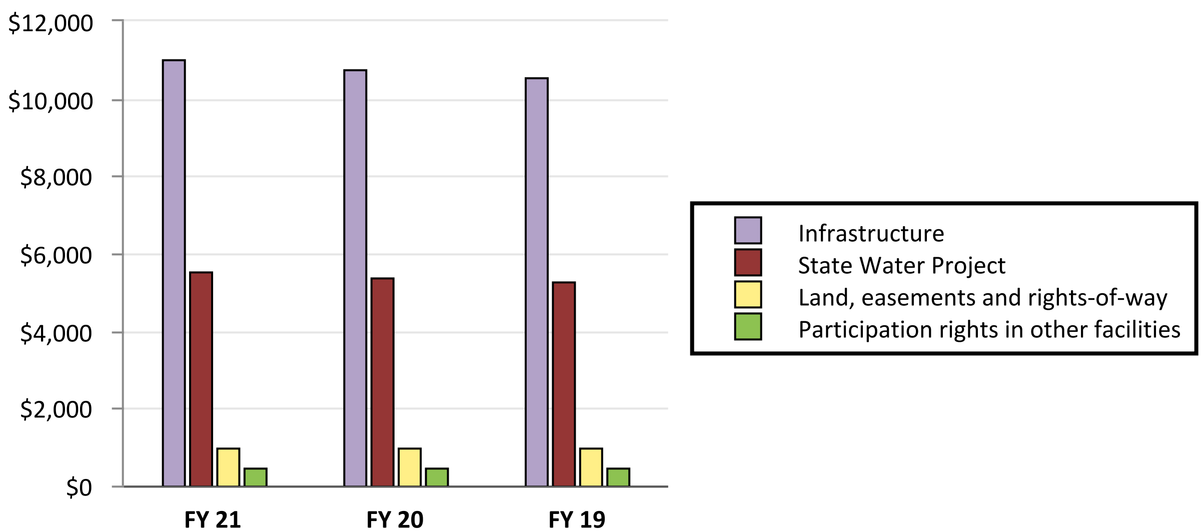
***First Quarter Fiscal 2021 Compared to First Quarter Fiscal 2020.*** For the three months ended September 30, 2020, nonoperating expenses of $36.1 million were $8.9 million higher than the prior year. The increase included $12.9 million higher write-off of construction in progress costs related to a recalculation of previously capitalized interest on construction partially offset by $3.6 million reduction of bond interest, net of amount capitalized due to bond refunding transactions to take advantage of lower interest rates.

***First Quarter Fiscal 2020 Compared to First Quarter Fiscal 2019.*** For the three months ended September 30, 2019, nonoperating expenses of $27.2 million were $2.3 million lower than the prior year. The decrease was primarily due to $2.5 million reduction of bond interest, net of amount capitalized due to bond refunding transactions to take advantage of lower interest rates.

## CAPITAL ASSETS

Capital assets include Metropolitan's water infrastructure, land and buildings, as well as participation rights in SWP and various other water programs. More detailed information on commitments for construction contracts are presented in Note 6(f) to the basic financial statements.

**First Quarter**
**GROSS CAPITAL ASSETS**
(Dollars in millions)




*Schedule of Capital Assets*

| (Dollars in millions) | September 30, 2020 | 2019 | 2018 |
|---|---|---|---|
| Land, easements and rights of way | **$ 984.9** | $ 985.1 | $ 995.2 |
| Construction in progress | **672.3** | 591.8 | 731.9 |
| Parker power plant and dam | **13.0** | 13.0 | 13.0 |
| Power recovery plants | **220.2** | 210.6 | 216.2 |
| Other dams and reservoirs | **1,613.5** | 1,568.3 | 1,560.7 |
| Water transportation facilities | **3,993.4** | 3,892.6 | 3,820.7 |
| Pumping plants and facilities | **357.6** | 303.0 | 302.4 |
| Treatment plants and facilities | **3,126.3** | 3,185.8 | 2,969.8 |
| Buildings | **178.5** | 187.4 | 162.5 |
| Other plant assets | **795.8** | 750.2 | 745.1 |
| Pre-operating expenses of original aqueduct | **44.6** | 44.6 | 44.6 |
| Participation rights in State Water Project | **5,544.9** | 5,400.8 | 5,254.6 |
| Participation rights in other facilities | **459.0** | 459.0 | 459.5 |
| Gross capital assets | **18,004.0** | 17,592.2 | 17,276.2 |
| Less accumulated depreciation and amortization | **(7,446.0)** | (7,121.3) | (6,812.7) |
| Total capital assets, net | **$ 10,558.0** | $ 10,470.9 | $ 10,463.5 |
| Net increase (decrease) from prior year | **$ 87.1** | $ 7.4 | $ (130.3) |
| Percent change | **0.8%** | 0.1% | (1.2%) |

***First Quarter Fiscal 2021 Compared to First Quarter Fiscal 2020.*** Net capital assets totaled approximately $10.6 billion and increased $87.1 million over the prior year. The increase included $289.3 million of construction spending and a net increase of $144.1 million in participation rights in SWP, offset by depreciation and amortization of $305.6 million and $40.7 million retirements of capital assets and write-off of construction in progress related to a recalculation of previously capitalized interest on construction.

The major capital asset additions for the twelve months ended September 30, 2020, excluding capitalized interest, included:

- $87.2 million for the pre-stressed concrete cylinder pipe reliability (PCCP) program; this program identifies pipelines whose age, location and condition warrant refurbishment/replacement to ensure long-term reliability of Metropolitan's PCCP lines water delivery.
- $58.4 million for the Colorado River Aqueduct (CRA) supply reliability and system expansion program; this program is designed to improve the reliability and flexibility of delivering Colorado River water during drought or other SWP delivery constraints.
- $50.1 million for the improvements in infrastructure reliability at the treatment plants; this program will replace or refurbish facilities and components at Metropolitan's five water treatment plants in order to continue to reliably meet water demands.
- $41.0 million for the system reliability program, which is designed to improve or modify facilities throughout Metropolitan's service area in order to utilize new processes and/or technologies, and to improve facility safety and overall reliability.
- $27.1 million for the distribution system's rehabilitation program; this program will replace or refurbish existing facilities within Metropolitan's distribution system including reservoirs, pressure control structures, hydroelectric power plants, and pipelines in order to reliably meet water demands.

Metropolitan's fiscal year 2021 capital investment plan includes $250.0 million principally for the Colorado River Aqueduct reliability programs, water treatment plants reliability program, systems and information technology improvements, distributions system rehabilitation projects, and the PCCP rehabilitation program.

***First Quarter Fiscal 2020 Compared to First Quarter Fiscal 2019.*** Net capital assets totaled approximately $10.5 billion and increased $7.4 million over the prior year. This increase included $240.2 million of construction spending and a net increase of $145.8 million in participation rights in SWP and other facilities, offset by depreciation and amortization of $308.7 million and $69.9 million net retirements of capital assets and write-off of construction in progress upon determination that no operating assets would result from the cost incurred.

The major capital asset additions for the twelve months ended September 30, 2019, excluding capitalized interest, included:

- $47.4 million for the distribution system's rehabilitation program.
- $40.7 million for the PCCP program.
- $40.6 million for the improvements in infrastructure reliability at the treatment plants program.
- $35.2 million for the system reliability program.
- $30.9 million for the CRA supply reliability and system expansion program.

## DEBT ADMINISTRATION – LONG-TERM DEBT

*Schedule of Long-term Debt, Including Current Portion*

| | September 30, | | |
|---|---|---|---|
| (Dollars in millions) | **2020** | 2019 | 2018 |
| General obligation bonds *(a)* | **$ 32.2** | $ 48.0 | $ 60.6 |
| Revenue bonds *(a)* | **3,762.7** | 3,816.4 | 4,109.8 |
| Revolving notes | **46.8** | 46.8 | 15.6 |
| Other, net *(b)* | **437.6** | 296.6 | 204.1 |
| | **$ 4,279.3** | $ 4,207.8 | $ 4,390.1 |
| Increase (decrease) from prior year | **$ 71.5** | $ (182.3) | $ (113.0) |
| Percent change | **1.7%** | (4.2%) | (2.5%) |

*(a) Includes refunding bonds.*
*(b) Consists of unamortized bond discounts and premiums.*

***First Quarter Fiscal 2021 Compared to First Quarter Fiscal 2020.*** At September 30, 2020, outstanding bonds and other long-term obligations totaled $4.3 billion, a net increase of $71.5 million or 1.7 percent from the prior year. The increase included $207.3 million in new revenue bonds and $141.1 million increase in premiums and discounts, which included $188.9 million increase related to bond refundings, as the premiums on new debt issued was more than the premiums outstanding on the debt refunded, offset by $47.8 million related to scheduled amortization. These increases were offset by $148.6 million of scheduled principal payments and $128.3 million of bond refundings, as the new debt issued was less than the amount of debt refunded.

***First Quarter Fiscal 2020 Compared to First Quarter Fiscal 2019.*** At September 30, 2019, outstanding bonds and other long-term obligations totaled $4.2 billion, a net decrease of $182.3 million or 4.2 percent from the prior year. The decrease was due to $171.2 million of bond refundings, as the new debt issued was less than the amount of debt refunded and $134.8 million of scheduled principal payments. These decreases were offset by $92.5 million increase in premiums and discounts, which included $129.3 million increase related to bond refundings, as the premiums on new debt issued was more than the premiums outstanding on the debt refunded, offset by $36.5 million related to scheduled amortization. In addition, revolving notes increased $31.2 million related to the Bank of America, N.A. notes issued for the CWF advance funding.

Additional information on Metropolitan's long-term debt can be found in Note 3 to the basic financial statements.

## CREDIT RATINGS

Metropolitan's credit ratings at September 30, 2020 are shown below.

| | Moody's Investors Service | Standard & Poor's Global | Fitch Ratings |
|---|---|---|---|
| General obligation bonds | Aaa | AAA | AA+ |
| Water revenue bonds-fixed rate | Aa1 | AAA | AA+ |
| Water revenue bonds-variable rate | VMIG 1 | A-1+ | F1+ |
| Subordinate water revenue bonds-fixed rate | N/A | AA+ | AA+ |
| Subordinate water revenue bonds-variable rate | N/A | A-1+ | F1+ |

## COVID-19 PANDEMIC

The spread of the novel strain of coronavirus and the disease it causes (now known as "COVID-19") is having significant negative impacts throughout the world, including in Southern California. The World Health Organization has declared the COVID-19 outbreak to be a pandemic, and states of emergency have been declared in the United States (the "U.S."), the State of California (State), and numerous counties throughout the State, including in the six counties all or portions of which comprise the service area of Metropolitan. On March 17, 2020, Metropolitan's General Manager declared a state of emergency at Metropolitan. The purposes behind these declarations are to initiate emergency response protocols, coordinate and formalize emergency actions across federal, state and local governmental agencies, and to proactively prepare for a wider spread of the virus.

The outbreak resulted in the implementation of "stay-at-home" (or "safer-at-home") orders by State and local governments for citizens to remain at home except for certain essential purposes, the imposition of restrictions on mass gatherings and the widespread temporary closings of businesses, universities and schools (including within the jurisdiction of Metropolitan and its member agencies). Although a gradual re-opening of various sectors has subsequently commenced in accordance with the Governor's re-opening plan (based upon local conditions in each county), the pandemic and governmental response has materially altered the behavior of people, disrupted business activity and resulted in a significant contraction of the U.S., State and regional economies. Employment data released since the imposition of the restrictions have shown a dramatic increase in unemployment rates. In addition, stock markets in the U.S. and globally experienced significant declines in the fourth quarter of fiscal year 2020 following the onset of COVID-19 outbreak that have been attributed to COVID-19 concerns, although some recovery has occurred in the subsequent months. On June 9, 2020, the National Bureau of Economic Research determined that the U.S. had entered into a recession in the prior months.

Metropolitan has taken, and is taking, a number of steps to protect the health of its employees, maintain continuity of its critical and essential business functions and avoid widespread impacts to its workforce from the COVID-19 outbreak. Metropolitan's Pandemic Action Plan is in effect. The following actions have been undertaken and are underway. A pandemic task force met regularly in the fourth quarter of fiscal year 2020 to review and update plans, prepare and implement action plans and coordinate Metropolitan's overall response activities. Further, in March 2020, Metropolitan's Emergency Operations Center (EOC) was activated in a virtual mode to monitor the spread of COVID-19 and coordinate emergency response activities throughout the organization and with other agencies. The EOC was demobilized as of June 30, 2020. Staff continues to communicate with county health agencies and the State, monitoring media reports and preparing and implementing action plans, as needed. Metropolitan's Water System is in a federally designated critical infrastructure sector with exemptions under Governor Newsom's Statewide "stay-at-home" order as needed to maintain continuity of operations. Personnel necessary to the operation and delivery of water supplies remain on-site, with staffing strategies being utilized to promote "social distancing." Enhanced facility cleaning and disinfection practices have also been put in place to promote a safe and healthful workplace for these employees. Telecommuting arrangements and paid administrative leave for employees performing other functions were implemented in March 2020 along with limiting non-essential business travel. It is anticipated that these employees will continue telecommuting at least through June 2021.

COVID-19 is not believed to present a threat to the safety of Metropolitan's treated water supplies. Metropolitan has also taken steps to ensure it has the necessary backup equipment, supplies and treatment chemicals in the event of disruptions to the supply chain for these items. To date, Metropolitan's ability to treat and deliver water has not been impaired.

Metropolitan is assessing the effects the ongoing COVID-19 outbreak will have on Metropolitan and its business and operations, as well as in the region, including the adverse financial impacts likely to be experienced by its member agencies. While Metropolitan continued to work on a variety of infrastructure and system reliability projects, certain Metropolitan projects and initiatives were initially paused as a result of the COVID-19 pandemic. Metropolitan has subsequently resumed its construction activities where the work can be done in keeping with best practices for pandemic safety. More broadly, press reports and analyses have suggested that water service providers serving residential, commercial and industrial end-use customers (referred to herein as "retail water service providers"), which includes some Metropolitan member agencies and agencies that purchase water from them, anticipate their customers are likely to be adversely impacted financially. As a measure to help mitigate such financial impacts and assure access to water service, on April 2, 2020, Governor Newsom issued an executive order which, among other things, orders the restoration of water service to residential customers in occupied residences whose service was discontinued for nonpayment during the state of emergency, and suspends the authority of retail water service providers to discontinue water service to residential and qualifying small business customers for non-payment. Voluntary measures may also be taken by retail water service providers in the State to assist their customers facing financial hardship as a result of the COVID-19 outbreak. The financial impacts to retail water customers and measures taken to assist them may result in more non-payment of utility bills than normal and forecasted, which is likely to further create financial stress on retail water service providers, including some Metropolitan member agencies.

In recognition of the changed circumstances and the uncertainties created by the ongoing COVID-19 outbreak, in the weeks following the declaration of a pandemic by the World Health Organization on March 11, 2020, Metropolitan reviewed its preliminary biennial budget initially presented to the Board in February 2020, and modified certain assumptions previously made in the proposed budget. The biennial budget for fiscal years 2020-21 and 2021-22, and water rates and charges for calendar years 2021 and 2022 adopted by the Board on April 14, 2020, reflect these adjustments, which include (i) a reduction in the overall rate increases for calendar years 2021 and 2022 from those previously proposed; (ii) a reduction in capital expenditures for fiscal year 2020-21 in recognition of likely delays in scheduling of construction work as a result of COVID-19; (iii) a reduction in the internal funding objective for the funding of capital program expenditures from current revenues for fiscal year 2020-21; and (iv) to review the adopted budget and rates no later than September 2020 to consider further impacts resulting from the COVID-19 crisis. On September 15, 2020, the Board approved a cost-cutting plan to reduce Metropolitan expenditures by $10.7 million and $1.0 million in fiscal years 2021 and 2022, respectively. The Board also directed Metropolitan staff to develop a penalty-free payment deferment program, evaluate potential new revenue-generating programs, and place a moratorium on non-emergency unbudgeted spending.

The COVID-19 outbreak is ongoing and developments will continue. The degree of impact to Metropolitan's finances and operations is difficult to predict due to the evolving nature of the COVID-19 pandemic, including uncertainties relating to (i) the duration and severity of the outbreak; (ii) the extent of the disruption to or decline in the local and global economies and financial markets; (iii) the degree to which business closures, increased unemployment, housing foreclosures and/or other economic consequences may reduce water demands in the region and Metropolitan's water transactions, or negatively affect future property values in Metropolitan's service area and/or Metropolitan's property tax levy receipts, and reduce Metropolitan's revenues; (iv) the extent to which a protracted disruption in the manufacturing or construction industry may affect supply chains or further delay construction schedules for, or the implementation of, Metropolitan's capital improvement programs and projects, or the costs of such programs or projects or Metropolitan's water system operations; and (v) what additional actions may be taken or required by governmental authorities to contain and respond to the outbreak and what the costs or impacts of such actions may be. It is expected that restrictions and limitations instituted related to COVID-19 will likely remain in place for some period, that the ongoing economic downturn may continue for many months and that the recovery may be prolonged. As a result, Metropolitan's finances and operations may be adversely impacted by COVID-19.

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# STATEMENTS OF NET POSITION

| (Dollars in thousands) | | September 30, 2020 | | 2019 |
|---|---|---|---|---|
| **ASSETS AND DEFERRED OUTFLOWS OF RESOURCES** | | (Unaudited) | | |
| **Current Assets:** | | | | |
| Cash and investments, at fair value (Notes 1d and 2): | | | | |
| Unrestricted (cost: $276,370 and $272,929 for fiscal years 2021 and 2020, respectively) | **$** | **278,709** | $ | 274,210 |
| Restricted (cost: $369,573 and $320,109 for fiscal years 2021 and 2020, respectively) | | **372,701** | | 321,613 |
| Total cash and investments | | **651,410** | | 595,823 |
| Receivables: | | | | |
| Water revenues | | **255,639** | | 235,853 |
| Interest on investments | | **2,436** | | 3,246 |
| Other, net (Note 1f) | | **201,081** | | 193,511 |
| Total receivables | | **459,156** | | 432,610 |
| Inventories (Note 1g) | | **110,855** | | 129,105 |
| Deposits, prepaid costs, and other (Note 8) | | **127,135** | | 129,093 |
| Total current assets | | **1,348,556** | | 1,286,631 |
| **Noncurrent Assets:** | | | | |
| Cash and investments, at fair value (Notes 1d and 2): | | | | |
| Unrestricted (cost: $268,305 and $235,486 for fiscal years 2021 and 2020, respectively) | | **270,576** | | 236,592 |
| Restricted (cost: $47,711 and $47,058 for fiscal years 2021 and 2020, respectively) | | **48,297** | | 47,460 |
| Total cash and investments | | **318,873** | | 284,052 |
| Capital assets: | | | | |
| Plant and equipment - non depreciable (Notes 1h and 6f) | | **1,657,239** | | 1,576,945 |
| Plant and equipment - depreciable (Notes 1h and 6f) | | **10,342,878** | | 10,155,460 |
| Participation rights in State Water Project (Notes 1i and 7) | | **5,544,931** | | 5,400,792 |
| Participation rights in other facilities (Note 1i) | | **459,049** | | 459,049 |
| Total capital assets | | **18,004,097** | | 17,592,246 |
| Less accumulated depreciation and amortization | | **(7,446,048)** | | (7,121,354) |
| Total capital assets, net | | **10,558,049** | | 10,470,892 |
| Other assets, net of current portion: | | | | |
| Deposits, prepaid costs, and other (Note 8) | | **369,269** | | 370,384 |
| Total other assets | | **369,269** | | 370,384 |
| Total noncurrent assets | | **11,246,191** | | 11,125,328 |
| Total assets | | **12,594,747** | | 12,411,959 |
| **Deferred Outflows of Resources:** | | | | |
| Loss on bond refundings (Note 1n) | | **14,989** | | 23,331 |
| Loss on swap terminations (Note 1n) | | **18,716** | | 17,804 |
| Pension related (Notes 1l, 1n, and 4) | | **85,243** | | 106,936 |
| OPEB related (Notes 1m, 1n, and 5) | | **33,506** | | 32,067 |
| Effective swaps (Note 1n) | | **10,108** | | 4,488 |
| Total deferred outflows of resources | | **162,562** | | 184,626 |
| **Total Assets and Deferred Outflows of Resources** | **$** | **12,757,309** | $ | 12,596,585 |

See accompanying notes to basic financial statements.

# STATEMENTS OF NET POSITION

| (Dollars in thousands) | September 30, 2020 (Unaudited) | 2019 |
|---|---|---|
| **LIABILITIES, DEFERRED INFLOWS OF RESOURCES, AND NET POSITION** | | |
| **Current Liabilities:** | | |
| Accounts payable and accrued expenses (Note 1j) | **$ 115,857** | $ 156,805 |
| Current portion of long-term debt | **1,099,264** | 501,519 |
| Current portion of accrued compensated absences (Note 1k) | **24,700** | 22,000 |
| Current portion of customer deposits and trust funds | **12,142** | 5,935 |
| Current portion of workers' compensation and third party claims (Note 11) | **4,122** | 4,884 |
| Current portion of other long-term liabilities | **221,409** | 216,599 |
| Accrued bond interest | **40,508** | 36,150 |
| Matured bonds and coupons not presented for payment | **1,725** | 1,754 |
| Total current liabilities | **1,519,727** | 945,646 |
| **Noncurrent Liabilities:** | | |
| Long-term debt, net of current portion | **3,133,285** | 3,659,515 |
| Revolving notes (Note 3a) | **46,800** | 46,800 |
| Accrued compensated absences, net of current portion (Note 1k) | **31,917** | 28,335 |
| Customer deposits and trust funds, net of current portion | **47,326** | 44,622 |
| Net pension liability (Note 4) | **668,995** | 634,037 |
| Net OPEB liability (Note 5) | **145,814** | 202,680 |
| Workers' compensation and third party claims, net of current portion (Note 11) | **10,381** | 8,640 |
| Fair value of interest rate swaps (Note 3e) | **67,007** | 61,388 |
| Other long-term liabilities, net of current portion | **2,186** | 2,205 |
| Total noncurrent liabilities | **4,153,711** | 4,688,222 |
| Total liabilities | **5,673,438** | 5,633,868 |
| **Commitments and Contingencies** (Note 6) | **—** | — |
| **Deferred Inflows of Resources:** | | |
| Pension related (Notes 1l, 1n and 4) | **21,298** | 24,207 |
| OPEB related (Notes 1m, 1n, and 5) | **47,337** | 7,288 |
| Total deferred inflows of resources | **68,635** | 31,495 |
| **Total Liabilities and Deferred Inflows of Resources** | **5,742,073** | 5,665,363 |
| **Net Position** (Note 10): | | |
| Net investment in capital assets, including State Water Project costs | **6,342,154** | 6,334,990 |
| Restricted for: | | |
| Debt service | **234,502** | 218,554 |
| Other | **276,799** | 238,741 |
| Unrestricted | **161,781** | 138,937 |
| Total net position | **7,015,236** | 6,931,222 |
| **Total Liabilities, Deferred Inflows of Resources, and Net Position** | **$ 12,757,309** | $ 12,596,585 |

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# STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

| (Dollars in thousands) | Three Months Ended September 30, 2020 | 2019 |
|---|---|---|
| | (Unaudited) | |
| **Operating Revenues** (Note 1c): | | |
| Water revenues | **$ 373,589** | $ 343,910 |
| Readiness-to-serve charges | **34,000** | 33,250 |
| Capacity charge | **7,635** | 7,610 |
| Power sales | **2,667** | 4,324 |
| Total operating revenues | **417,891** | 389,094 |
| **Operating Expenses:** | | |
| Power and water costs | **129,014** | 107,490 |
| Operations and maintenance | **133,091** | 131,648 |
| Total operating expenses | **262,105** | 239,138 |
| Operating income before depreciation and amortization | **155,786** | 149,956 |
| Less depreciation and amortization | **(86,329)** | (74,836) |
| Operating income | **69,457** | 75,120 |
| **Nonoperating Revenues (Expenses)** (Note 1p): | | |
| Taxes, net (Note 1e) | **38,217** | 35,774 |
| Bond interest, net of $2,000 of interest capitalized in fiscal years 2021 and 2020 (Note 1h) | **(22,623)** | (26,174) |
| Investment income, net | **1,781** | 5,977 |
| Loss on disposal of plant assets | **(12,938)** | — |
| Other, net | **1,837** | 4,326 |
| Total nonoperating revenues, net | **6,274** | 19,903 |
| **Changes in Net Position Before Contributions** | **75,731** | 95,023 |
| Capital contributions (Note 1o) | **—** | — |
| Changes in net position | **75,731** | 95,023 |
| Net position at June 30, 2020 and 2019 | **6,939,505** | 6,836,199 |
| **Net position at September 30, 2020 and 2019** | **$ 7,015,236** | $ 6,931,222 |

See accompanying notes to basic financial statements.

# STATEMENTS OF CASH FLOWS

| (Dollars in thousands) | Three Months Ended September 30, 2020 | 2019 |
|---|---|---|
| | (Unaudited) | |
| **Cash Flows from Operating Activities:** | | |
| Cash received from water sales | **$ 292,055** | $ 241,953 |
| Cash received from readiness-to-serve charges | **10,437** | 9,701 |
| Cash received from capacity charge | **3,422** | 3,335 |
| Cash received from power sales | **1,364** | 4,969 |
| Cash received from other exchange transactions | **49,126** | 36,245 |
| Cash paid for operations and maintenance expenses | **(68,355)** | (67,411) |
| Cash paid to employees for services | **(105,980)** | (101,512) |
| Cash paid for power and water costs | **(118,142)** | (132,625) |
| Other cash flows for operating activities | **157** | (31) |
| Net cash provided (used) by operating activities | **64,084** | (5,376) |
| **Cash Flows from Noncapital Financing Activities:** | | |
| Proceeds from other collections | **2,491** | 2,540 |
| Net cash provided by noncapital financing activities | **2,491** | 2,540 |
| **Cash Flows from Capital and Related Financing Activities:** | | |
| Acquisition and construction of capital assets | **(65,350)** | (69,432) |
| Payments for State Water Project costs | **(74,471)** | (74,290) |
| Payments for bond issuance costs | **(116)** | (1,638) |
| Principal paid on debt | **(159,585)** | (116,825) |
| Interest paid on debt | **(58,857)** | (53,866) |
| Proceeds from tax levy | **4,851** | 4,318 |
| Transfer from escrow trust accounts | **2,588** | 1,308 |
| Net cash used by capital and related financing activities | **(350,940)** | (310,425) |
| **Cash Flows from Investing Activities:** | | |
| Purchase of investment securities | **(646,640)** | (741,670) |
| Proceeds from sales and maturities of investment securities | **926,372** | 1,052,142 |
| Investment income | **4,477** | 2,878 |
| Net cash provided by investing activities | **284,209** | 313,350 |
| Net change in cash | **(156)** | 89 |
| Cash at July 1, 2020 and 2019 | **161** | 22 |
| **Cash at September 30, 2020 and 2019 (Notes 1b and 2a)** | **$ 5** | $ 111 |

See accompanying notes to basic financial statements.

# STATEMENTS OF CASH FLOWS

| (Dollars in thousands) | Three Months Ended September 30, 2020 | 2019 |
|---|---|---|
| **RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES** | (Unaudited) | |
| **Operating Income** | **$ 69,457** | $ 75,120 |
| **Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities:** | | |
| Depreciation and amortization expense | **86,329** | 74,836 |
| Increase in accounts receivable | **(47,381)** | (88,869) |
| Decrease (increase) in inventories | **7,610** | (6,102) |
| Increase in deposits, prepaid costs, and other | **(108,218)** | (136,794) |
| Increase (decrease) in accounts payable, and accrued expenses | **7,524** | (2,928) |
| Increase in other items | **48,763** | 79,361 |
| Total Adjustments | **(5,373)** | (80,496) |
| **Net cash provided (used) by operating activities** | **$ 64,084** | $ (5,376) |
| **Significant Noncash Investing, Capital and Financing Activities** | | |
| Refunding bonds proceeds received in escrow trust fund | **$ 370,417** | $ — |
| Debt defeased through escrow trust fund with refunding debt | **$ (368,935)** | $ — |
| **RECONCILIATION OF CASH AND INVESTMENTS TO CASH** | | |
| Unrestricted cash and investments (at September 30, 2020 and 2019 includes $5 and $111 of cash, respectively) | **$ 549,285** | $ 510,802 |
| Restricted cash and investments | **420,998** | 369,073 |
| Total cash and investments, at fair value | **970,283** | 879,875 |
| Less: carrying value of investments | **(970,278)** | (879,764) |
| **Total Cash (Notes 1b and 2a)** | **$ 5** | $ 111 |

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# 1. REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

## (a) Reporting Entity

The Metropolitan Water District of Southern California (Metropolitan), a special district of the State of California, was organized in 1928 by vote of the electorates of several Southern California cities following adoption of the Metropolitan Water District Act (Act) by the California Legislature. Metropolitan's primary purposes under the Act are to develop, store, and distribute water, at wholesale, to its member public agencies for domestic and municipal purposes. Surplus water is sold for other beneficial uses, including agricultural use. Metropolitan's service area comprises approximately 5,200 square miles and includes portions of the six counties of Los Angeles, Orange, Riverside, San Bernardino, San Diego, and Ventura. There are 26 independent member agencies of Metropolitan, consisting of 14 cities, 11 municipal water districts, and one county water authority. Metropolitan has no financial accountability for its member agencies. Metropolitan is governed by a 38-member Board of Directors (Board) comprised of representatives of the member agencies. Representation and voting rights are based on assessed valuations of property pursuant to Sections 52 and 55 of the Act. Each member agency is entitled to have at least one representative on the Board plus an additional representative for each full five percent of the assessed valuation of real property within the jurisdictional boundary of each member agency. Changes in relative assessed valuation do not terminate any director's term. Accordingly, the Board may, from time to time, have more or fewer than 38 directors. However, effective January 1, 2020, no member agency shall have fewer than the number of representatives the agency had as of January 1, 2019. No single member agency has a voting majority.

The Metropolitan Water District Asset Financing Corporation (MWDAFC) was incorporated on June 19, 1996. The MWDAFC is a California nonprofit public benefit corporation formed to assist Metropolitan by acquiring, constructing, operating and maintaining facilities, equipment, or other property needed by Metropolitan and leasing or selling such property to Metropolitan. The MWDAFC is governed by a board of five directors, each of whom must be a member of Metropolitan's Board. MWDAFC had no financial operations during the three months ended September 30, 2020 or 2019. MWDAFC is a component unit of Metropolitan and its activities will be blended with those of Metropolitan for financial reporting purposes should it commence operations.

## (b) Principles of Presentation

Metropolitan operates as an enterprise fund and applies all applicable GASB pronouncements in its accounting and reporting. The accompanying basic financial statements reflect the flow of economic resources measurement focus and the full accrual basis of accounting. Under full accrual accounting, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred regardless of the timing of related cash flows.

For purposes of the statements of cash flows, Metropolitan defines cash as demand account balances and cash on hand.

## (c) Revenue Policies

Water revenues, which include funds received from charges for the sale and availability of water, including water rates and other exchange and wheeling transactions, are the principal source of Metropolitan's revenues. Other sources of operating revenue include readiness-to-serve charges, capacity charge, and hydroelectric power sales. Other revenues include ad valorem property taxes and investment income.

Water rates are established by the Board on a biennial basis. Water rates are supported by cost of service studies. Water rates are not subject to regulation by the California Public Utilities Commission or by any other local, state, or federal agency. Water is delivered to the member agencies on demand and revenue is recognized at the time of sale.

Metropolitan's rate structure consists of unbundled rate elements (supply, treatment, conveyance and distribution, power, and demand management) designed to provide transparency regarding the cost of specific functions to member agencies. It is designed to improve regional water resources management and accommodate a water transfer market. The rate structure also includes tiered pricing for supply, a capacity charge, and a readiness-to-serve charge.

### (d) Fair Value Measurements

Metropolitan categorizes the fair value measurements for assets and liabilities within the fair value hierarchy established by U.S. GAAP. The hierarchy is based on the valuation inputs of assets and liabilities as follows: Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that a government can access at the measurement date; Level 2 inputs are inputs—other than quoted prices—that are observable for identical assets or liabilities, either directly or indirectly; and Level 3 inputs are unobservable inputs, such as management's assumption of the default rate among underlying mortgages of a mortgage-backed security. Metropolitan reports its investments and liabilities using valuation techniques consistent with market and cost approaches to determine the fair value.

### (e) Taxing Authority

Metropolitan is expressly empowered under the Act to levy and collect taxes on all taxable property within its boundaries for the purpose of carrying on its operations and paying its obligations, subject to certain limitations in the Act, the California Revenue and Taxation Code, and the California Constitution. Property taxes are levied annually by the Board effective as of July 1, using a lien date of January 1, and are payable by property owners in two equal installments that are due on November 1 and February 1, and become delinquent after December 10 and April 10, respectively. Property taxes levied by Metropolitan are billed and collected by the counties in its service area and are remitted to Metropolitan periodically throughout the year.

Property tax revenue is used to pay Metropolitan's general obligation bond debt service and a portion of its obligations under its contract with the state for a water supply and participation in the SWP (the State Water Contract). In setting the annual levy, Metropolitan takes into account potential delinquencies, tax allocations to the successor agencies of former redevelopment agencies, and supplemental tax collections. Metropolitan recognizes property taxes receivable on July 1 of each fiscal year and recognizes revenue over the following 12-month period beginning July 1 through June 30 (the period for which the tax is levied).

As a result of legislation enacted in 1984, commencing with the fiscal year ended June 30, 1991, tax levies, other than annexation taxes, are limited to the amount needed to pay debt service on Metropolitan's general obligation bonds and Metropolitan's proportionate share of general obligation bond debt service of the state under the State Water Contract. However, under the terms of the 1984 legislation, the Board may suspend this particular restriction upon a finding that doing so is essential to Metropolitan's fiscal integrity. The Board made such a finding for fiscal years ended June 30, 2014 through 2021, and maintained the tax rate for those fiscal years at the rate levied during fiscal year ended June 30, 2013 to pay a portion of State Water Contract costs other than general obligation debt service.

### (f) Other Receivables

Other receivables include amounts for taxes, hydroelectric power sales, readiness-to-serve charges, and other billings.

### (g) Inventories

Metropolitan's inventories are valued based on a moving-average cost. Expenses are recorded when inventories are used. Components of inventories at September 30, 2020 and 2019 were as follows:

| | September 30, | | | |
|---|---|---|---|---|
| (Dollars in thousands) | | **2020** | | 2019 |
| Water in storage | **$** | **95,864** | $ | 114,805 |
| Operating supplies | | **14,991** | $ | 14,300 |
| Total inventories | **$** | **110,855** | $ | 129,105 |

### (h) Capital Assets

Metropolitan's capital assets include plant and equipment, which are recorded at cost. Construction costs are capitalized if they exceed $50,000 and the asset has a useful life of at least five years. The cost of constructed assets may include labor, materials, certain general and administrative expenses, and interest incurred during construction periods. Depreciation is calculated using the straight-line method based on the estimated average useful lives of the assets, which are 10 to 80 years for buildings, storage, distribution facilities, and miscellaneous assets and 10 to 50 years for treatment plants and hydroelectric power recovery facilities. Improvements or refurbishments with aggregated costs that meet capitalization thresholds and that extend the useful life of an existing asset by at least 5 years are capitalized.

Major computer systems software, whether purchased or internally developed, is capitalized if the cost exceeds $250,000 and the useful life is at least three years. Vehicles and operating equipment are capitalized if the cost equals or exceeds $5,000 and the useful life is at least four years. Depreciation is calculated using the straight-line method based on the estimated useful lives and ranges from 3 to 10 years for major computer systems software and 4 to 10 years for vehicles and operating equipment.

### (i) Participation Rights

Metropolitan participates in various storage and water management programs entitling it to certain water rights. Projects include the SWP and various storage and water management programs. Metropolitan's participation in these projects is through cash payments. The value of participation rights is equal to the amounts spent for the construction of capital assets, such as pipelines, pumping facilities, and storage facilities, and amortized over the life of the agreements. These assets are not owned by Metropolitan. Certain projects also require payments for ongoing maintenance; those payments are charged to expense as incurred. (See Note 7.)

### (j) Disaggregation of Payable Balances

Accounts payable and accrued expenses at September 30, 2020 and 2019 were as follows:

| | September 30, | |
|---|---|---|
| (Dollars in thousands) | **2020** | 2019 |
| Department of Water Resources (SWP): | | |
| Capital, operating, maintenance, power, replacement, and variable power | **$ 80,229** | $ 112,522 |
| Vendors | **16,710** | 29,401 |
| Accrued power costs | **5,529** | 2,072 |
| Accrued salaries | **7,701** | 7,199 |
| Conservation credits | **5,688** | 5,611 |
| Total accounts payable and accrued expenses | **$ 115,857** | $ 156,805 |

### (k) Compensated Absences

Metropolitan's employees earn vacation, sick, and compensatory leave in varying amounts depending primarily on length of service. Upon termination from Metropolitan service, employees are entitled to full payment for accrued vacation and compensatory leave at their final pay rates, and are entitled to payment for approximately one-half of their accrued sick leave at such rates. Metropolitan records its obligations for vacation, sick, and compensatory leave earned by eligible employees based on current pay rates. The allocations to the current and long-term portions of these vested obligations were based on experience and projections of turnover.

### (l) Pension Accounting

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

GASB requires that the reported results must pertain to liability and asset information within certain defined timeframes. For this report, the following timeframes are used:

Valuation Date (VD): June 30, 2018
Measurement Date (MD): June 30, 2019
Measurement Period: July 1, 2018 to June 30, 2019

### (m) OPEB Accounting

For purposes of measuring the net OPEB liability, deferred outflows of resources and deferred inflows of resources related to OPEB, and OPEB expense, information about the fiduciary net position of Metropolitan's plan (OPEB Plan), the assets of which are held by the California Employer's Retiree Benefit Trust (CERBT), and additions to/deductions from the OPEB Plan's fiduciary net position have been determined on the same basis. For this purpose, benefit payments are recognized when currently due and payable in accordance with the benefit terms. Investments are reported at fair value.

GASB requires that the reported results must pertain to liability and asset information within certain defined timeframes. For this report, the following timeframes are used:

Valuation Date (VD): June 30, 2019
Measurement Date (MD): June 30, 2019
Measurement Period: July 1, 2018 to June 30, 2019

## (n) Deferred Outflows/Inflows of Resources

The net investment in capital assets, including State Water Project costs of $6.3 billion at September 30, 2020 and 2019, includes the effect of deferring the recognition of losses from bond refundings. The deferred outflows from losses on bond refundings at September 30, 2020 and 2019 were $15.0 million and $23.3 million, respectively. This is amortized and recognized as a component of interest expense in a systematic and rational manner over the remaining life of the old or the new debt, whichever is shorter.

The unrestricted net position amount of $161.8 million and $138.9 million at September 30, 2020 and 2019, respectively, includes the effect of deferring the recognition of losses from swap terminations resulting in defeasance of debt, the increase or decrease in fair value of Metropolitan's effective interest rate swaps, and deferred amounts related to pension and OPEB.

The deferred outflows from losses on swap terminations resulting in debt defeasance at September 30, 2020 and 2019, respectively, were $18.7 million and $17.8 million. These deferred outflows of resources are amortized and recognized as a component of interest expense in a systematic and rational manner over the remaining life of the old debt or the life of the new debt, whichever is shorter.

The deferred outflows related to pension at September 30, 2020 and 2019 were $85.2 million and $106.9 million, respectively. The deferred inflows related to pension at September 30, 2020 and 2019 were $21.3 million and $24.2 million, respectively.

The deferred outflows related to OPEB at September 30, 2020 and 2019 were $33.5 million and $32.1 million, respectively. The deferred inflows related to OPEB at September 30, 2020 and 2019 were $47.3 million and $7.3 million, respectively.

Deferred outflows and inflows of resources related to the net difference between projected and actual earnings on pension and OPEB plan investments are amortized on a straight-line basis over five years. All other deferred outflows and inflows of resources related to pension and OPEB are amortized on a straight-line basis over the expected average remaining service lives of all members with benefits as of the beginning of the measurement period.

The deferred outflow from the decrease in fair value of interest rates swaps of $10.1 million and $4.5 million at September 30, 2020 and 2019, respectively, would be recognized as an investment loss upon the early termination of the swaps. Metropolitan will only terminate its interest rate swap agreements in advance of the contractual termination dates if market conditions permit. The deferred outflow would also be recognized as an investment loss, if the swaps were determined no longer to be effective hedges. Finally, if the bond associated with a swap is refunded, the deferred outflow would be reduced and the deferred loss on refunding would be increased by the same amount. The deferred loss would be amortized as a component of interest expense over the life of the old debt or the new debt, whichever is shorter.

### (o) Capital Contributions

Capital contributions are comprised of federal, state, and private grants. These grants are typically of a reimbursable nature: Metropolitan first pays for the project and then the granting agency reimburses Metropolitan for its eligible expenses. The portion of the grants restricted for capital purposes are reflected as capital contributions in the Statements of Revenues, Expenses and Changes in Net Position when they are earned, irrespective of the timing of the receipts. Examples of capital projects where grants are received include water treatment plant improvements, such as fluoridation and water storage programs.

### (p) Operating and Nonoperating Revenues and Expenses

Metropolitan's primary purpose is to provide a supplemental supply of water for domestic and municipal uses. Accordingly, Metropolitan defines operating revenues as revenues derived from the sale and availability of water, including water rates and other exchange and wheeling transactions. It also includes readiness-to-serve charges, capacity charge, and hydroelectric power sales. Operating expenses include the cost of sales and services, administrative expenses, and depreciation and amortization of capital assets.

Revenues from property taxes and investment income, as well as interest expense on outstanding debt, are related to capital and financing activities and are defined as nonoperating revenues and expenses.

### (q) Restricted and Unrestricted Resources

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

### (r) Use of Estimates

The preparation of basic financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the basic financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### (s) New Accounting Pronouncements

In May 2020, the GASB issued Statement No. 95 (GASB 95), *Postponement of the Effective Dates of Certain Authoritative Guidance,* with the primary objective of providing temporary relief to governments and other stakeholders in light of the COVID-19 pandemic. As a result of GASB 95, all GASB Statements that would have been applicable in fiscal year 2020 were delayed until fiscal year 2021 or later, as noted on the next page.

Metropolitan is currently evaluating its accounting practices to determine the potential impact on the financial statements for the following GASB Statements that will be implemented in a future fiscal year:

- GASB Statement No. 87, *Leases* (effective for fiscal year 2022).
- GASB Statement No. 89, *Accounting for Interest Cost Incurred before the End of a Construction Period* (effective for fiscal year 2022).
- GASB Statement No. 90, *Majority Equity Interests - an amendment of GASB Statements No. 14 and No. 61* (effective for fiscal year 2021).
- GASB Statement No. 92*, Omnibus 2020* (effective for fiscal year 2022).
- GASB Statement No. 93*, Replacement of Interbank Offered Rates* (effective for fiscal year 2022).
- GASB Statement No. 94*, Public-Private and Public-Public Partnerships and Availability Payment Arrangements* (effective for fiscal year 2023).
- GASB Statement No. 96*, Subscription-Based Information Technology Arrangements* (effective for fiscal year 2023).
- GASB Statement No. 97*, Certain Component Unit Criteria, and Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans—an amendment of GASB Statements No. 14 and No. 84, and a supersession of GASB Statement No. 32* (effective for fiscal year 2022).

The following pronouncements were issued by GASB but were determined to not be applicable to Metropolitan's financial statements:

- GASB Statement No. 84, *Fiduciary Activities.*
- GASB Statement No. 91*, Conduit Debt Obligations.*

## 2. CASH AND INVESTMENTS

As a public agency, Metropolitan's investment practices are prescribed by various provisions of the California Government Code and the Act, as well as by administrative policies. Metropolitan's statement of investment policy is approved annually by the Board and describes the Treasurer's investment authority, practices, and limitations. The basic investment policy objectives, in order of importance, are safety of principal, liquidity, and return on investment.

Cash and investments may or may not be restricted as to use, depending on the specific purposes for which such assets are held (see Notes 2d and 10).

A summary of Metropolitan's deposit and investment policies, information on interest and credit risks, and restricted cash and investments is provided below.

### (a) Deposits

The California Government Code requires California banks and savings and loan associations to secure a local government agency's deposits by pledging government securities as collateral.

As of September 30, 2020, Metropolitan had no cash balances with financials institutions and had $106,000 at September 30, 2019, while cash on hand was $5,000 at each year-end.

### (b) Investments

Metropolitan is permitted by State law and Board policy to invest in a variety of instruments including U.S. Treasury securities, federal agencies, Supranationals, asset-backed, repurchase agreements, negotiable certificates of deposit, bankers' acceptances, prime commercial paper, Government-sponsored enterprise (GSE), California local agency securities, including securities issued by Metropolitan, medium-term corporate notes, time deposits, investment contracts, money market funds, California Asset Management Program (CAMP), and Local Agency Investment Fund (LAIF).

As of September 30, 2020 and 2019, Metropolitan had the following investments at fair value:

| | September 30, | |
|---|---|---|
| (Dollars in thousands) | **2020** | 2019 |
| U.S. Treasury securities | **$ 109,285** | $ 79,510 |
| Federal agency securities | **58,352** | 62,586 |
| Asset-backed securities | **50,018** | — |
| Supranationals | **59,482** | 24,834 |
| Prime commercial paper | **72,412** | 79,500 |
| Medium-term corporate notes | **148,503** | 225,480 |
| Negotiable certificates of deposit | **105,019** | 143,143 |
| Money Market Funds | **4,392** | 76,352 |
| GSE | **54,788** | 71,118 |
| Municipal bonds | **3,370** | 2,124 |
| CAMP | **229,657** | 50,117 |
| LAIF | **75,000** | 65,000 |
| Total investments | **$ 970,278** | $ 879,764 |

Metropolitan categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The following is the summary of the fair value hierarchy of the fair value of investments of Metropolitan as of September 30, 2020 and 2019:

| | | Fair Value Measurement Using | | | | |
|---|---|---|---|---|---|---|
| (Dollars in thousands) | **9/30/2020** | **Quoted Prices in Active Markets for Identical Assets (Level 1)** | **Significant Other Observable Inputs (Level 2)** | 9/30/2019 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) |
| Investments by fair value level: | | | | | | |
| U.S. Treasury securities | **$ 109,285** | **$ 109,285** | **$ —** | $ 79,510 | $ 79,510 | $ — |
| Federal agency securities | **58,352** | **58,352** | **—** | 62,586 | 62,586 | — |
| Asset-backed securities | **50,018** | **46,238** | **3,780** | — | — | — |
| Supranationals | **59,482** | **59,482** | **—** | 24,834 | 24,834 | — |
| Prime commercial paper | **72,412** | **17,477** | **54,935** | 79,500 | — | 79,500 |
| Medium-term corporate notes | **148,503** | **148,503** | **—** | 225,480 | 225,480 | — |
| Negotiable certificates of deposit | **105,019** | **105,019** | **—** | 143,143 | 103,076 | 40,067 |
| GSE | **54,788** | **54,788** | **—** | 71,118 | 71,118 | — |
| Municipal bonds | **3,370** | **3,370** | **—** | 2,124 | 2,124 | — |
| Total investments by fair value level | **$ 661,229** | **$ 602,514** | **$ 58,715** | $ 688,295 | $ 568,728 | $ 119,567 |
| Investments not subject to fair value level: | | | | | | |
| Money Market Funds [(1)] | **4,392** | | | 76,352 | | |
| CAMP | **229,657** | | | 50,117 | | |
| LAIF | **75,000** | | | 65,000 | | |
| Total investments | **$ 970,278** | | | $ 879,764 | | |

[(1)] *As of September 30, 2020 and 2019, the balance was invested in Dreyfus Government Cash Management, Dreyfus AMT-Free Tax Exempt Cash Management (DGCXX & DEIXX) and BlackRock Treasury Trust (TTXX).*

Investments classified in Level 1 of the fair value hierarchy, valued at $602.5 million and $568.7 million as of September 30, 2020 and 2019, respectively, are valued using quoted prices in active markets.

Prime commercial paper totaling $54.9 million and $79.5 million as of September 30, 2020 and 2019, respectively, asset-backed securities totaling $3.8 million as of September 30, 2020, and negotiable certificates of deposit totaling $40.1 million as of September 30, 2019, classified in Level 2 of the fair value hierarchy were valued using matrix pricing.

Metropolitan owns investments utilizing a stable one dollar per share value. These investment assets are exempt from reporting under the fair value measurement levels. There are no redemption restrictions for the investments reported at a value of one dollar per share.

***Interest rate risk.*** In accordance with Metropolitan's investment policy, interest rate risk was managed by limiting the duration of the various portfolio segments. Each segment has limitations on the amount of duration exposure (see the following for specific durations).

*Internally Managed Segment*

This segment of the portfolio was managed against the Intercontinental Exchange Bank of America Merrill Lynch (ICE BoAML) 3-Month Treasury Bill Index, approved by the Finance and Insurance Committee. The benchmark duration as of September 30, 2020 and 2019 was 0.23 and the portfolio duration was permitted to vary from the benchmark by plus or minus 0.50 and 0.20, respectively. As of September 30, 2020 and 2019, Metropolitan's investments and portfolio durations for this segment were as follows:

| | September 30, | | | |
|---|---|---|---|---|
| | **2020** | | 2019 | |
| (Dollars in thousands) | **Fair value** | **Duration** | Fair value | Duration |
| U.S. Treasury securities | **$ 45,024** | **0.75** | $ 24,299 | 1.48 |
| Federal agency securities | **56,182** | **1.30** | 62,336 | 0.99 |
| Asset-backed securities | **50,018** | **2.08** | — | — |
| Supranationals | **59,482** | **0.61** | 24,834 | — |
| Prime commercial paper | **72,412** | **0.50** | 79,500 | 0.38 |
| Medium-term corporate notes | **74,033** | **0.77** | 154,053 | 0.81 |
| Negotiable certificates of deposit | **105,019** | **0.59** | 143,143 | 0.46 |
| Municipal bonds | **2,140** | **1.92** | 775 | 0.80 |
| GSE | **—** | **—** | 7,676 | 2.54 |
| Money Market Funds | **1** | **—** | 75,361 | — |
| CAMP | **229,657** | **—** | 50,117 | — |
| LAIF | **75,000** | **—** | 65,000 | — |
| Total portfolio segment | **$ 768,968** | | $ 687,094 | |
| Portfolio duration | | **0.53** | | 0.51 |

### *Externally Managed Segment*

This segment of the portfolio was managed against the ICE BoAML, U.S. Corporate and Government, one to five years, A-Rated and above index approved by the Finance and Insurance Committee. The benchmark duration as of September 30, 2020 and 2019 were 2.67 and 2.60, respectively, and the portfolio duration was permitted to vary from the benchmark by plus or minus 1.50. As of September 30, 2020 and 2019, Metropolitan's investments and portfolio durations for this segment were as follows:

| | September 30, | | | |
|---|---|---|---|---|
| | **2020** | | 2019 | |
| (Dollars in thousands) | **Fair value** | **Duration** | Fair value | Duration |
| U.S. Treasury securities | **$ 62,618** | **3.28** | $ 51,641 | 3.19 |
| Medium-term corporate notes | **74,470** | **2.45** | 71,427 | 2.15 |
| Money Market Funds | **3,901** | **—** | 520 | — |
| GSE | **54,788** | **1.37** | 63,442 | 2.14 |
| Total portfolio segment | **$ 195,777** | | $ 187,030 | |
| Portfolio duration | | **2.37** | | 2.43 |

### *Bond Reserves and Lake Mathews Segment*

Investments in the bond reserves were managed based on the requirements of each of the bond issues. The Lake Mathews trust funds were managed in a manner that preserved the principal and provided the necessary liquidity to pay its operating expenses. Per Board authorization, the Treasurer was authorized to invest these monies in excess of five years.

As of September 30, 2020 and 2019, Metropolitan's investments and portfolio durations for this segment were as follows:

| | September 30, | | | |
|---|---|---|---|---|
| | **2020** | | 2019 | |
| (Dollars in thousands) | **Fair value** | **Duration** | Fair value | Duration |
| U.S. Treasury securities | **$ 1,643** | **0.75** | $ 3,570 | 1.00 |
| Federal agency securities | **2,170** | **1.77** | 250 | 0.52 |
| Money Market Funds | **490** | **—** | 471 | — |
| Municipal bonds | **1,230** | **3.41** | 1,349 | 3.89 |
| Total portfolio segment | **$ 5,533** | | $ 5,640 | |
| Weighted average duration | | **1.68** | | 1.59 |

***Credit risk.*** Credit risk was managed by purchasing investments with the nationally recognized credit ratings specified in Metropolitan's investment policy. Additionally, the policy required monitoring the credit ratings of securities held in the portfolio, and if the securities' credit ratings were downgraded, evaluating for potential sale. For certain securities, additional requirements included consideration of net worth, length of time in business, and specified market values.

Presented in the following table is the minimum rating required, if applicable, by investment type pursuant to Metropolitan's investment policy and State law:

| **Investment Type** | **Minimum Rating** |
|---|---|
| U.S. Treasury<br>Federal Agency Obligations | Not applicable. |
| Bankers' acceptances | A-1 or its equivalent or better by a nationally recognized rating agency (NRSRO). |
| Prime commercial paper | Highest ranking or highest letter and number rating as provided by a NRSRO. |
| Negotiable certificates of deposit | A (long-term) or A-1 (short-term) or their equivalent or better by a NRSRO. |
| Time deposits | All deposits must be collateralized as required by California Government Code Sections 53630 et seq. The Treasurer may waive collateral for the portion of any deposits that is insured pursuant to federal law. |
| Asset-backed securities<br>GSE | Rating category of at least 'AA' or equivalent or better by a NRSRO. |
| Supranationals | Rating category of at least 'AA' or equivalent or better by a NRSRO. |
| CAMP | Rating category of 'AAAm' or its equivalent or better by a NRSRO. |
| Repurchase agreements | Limited to primary dealers or financial institutions in a rating category of 'A' or its equivalent or better by a NRSRO. |
| Medium-term corporate notes | Rating category of 'A' or its equivalent or better by a NRSRO. |
| LAIF | Not applicable. |
| Money market funds | Highest ranking by not less than two NRSROs or must retain an investment advisor that meets specified requirements. |
| Municipal bonds | A (long-term) or A-1 (short-term) or their equivalent or better by a NRSRO. |

At September 30, 2020 and 2019, Metropolitan's portfolio was invested in the following securities by rating:

| | | September 30, | |
|---|---|---|---|
| | | **2020** | 2019 |
| (Dollars in thousands) | Rating | **Fair value** | Fair value |
| U.S. Treasury securities | N/A(1) | **$ 109,285** | $ 79,510 |
| Federal agency securities | N/A(1) | **58,352** | 62,586 |
| Asset-backed securities | AA or higher | **50,018** | — |
| Supranationals | AA or higher | **59,482** | 24,834 |
| Prime commercial paper | A1/P1(2) | **72,412** | 79,500 |
| Medium-term corporate notes | A(2) | **148,503** | 225,480 |
| Negotiable certificates of deposit | F1(2) | **105,019** | 143,143 |
| Money Market Funds | AAA | **4,392** | 76,352 |
| GSE | AAA | **54,788** | 71,118 |
| Municipal bonds | A(2) | **3,370** | 2,124 |
| CAMP | AAAm | **229,657** | 50,117 |
| LAIF | N/A(3) | **75,000** | 65,000 |
| Total portfolio | | **$ 970,278** | $ 879,764 |

(1)*Credit ratings are not applicable to obligations of the U.S. Government or obligations explicitly guaranteed by the U.S. Government.*
(2)*A (long-term) or A-1 (short-term) or better e.g. F1+, A1+, AA, or AAA.*
(3)*LAIF is not rated.*

***Concentration of credit risk.*** In accordance with Metropolitan's investment policy, the minimum requirements for limiting concentration of credit risk defined the maximum percent allowable for investment in each security type as well as the percent allowable for investment by issuer per type. Generally, the maximum allowable for investment by security type varied from 20 percent, for GSE and money market funds, to 100 percent for U.S. Treasury and federal agency securities. The percentages of investments that can be purchased by a single issuer is limited to 5 percent for banker's acceptance, prime commercial paper, medium-term corporate notes, negotiable certificates of deposit, municipal bonds, and asset-backed securities.

The following table identifies Metropolitan's limits and the percent invested by security type based on fair value, as of September 30, 2020 and 2019.

| | Investment Policy Limits | Percent of Portfolio | |
|---|---|---|---|
| | | **2020** | 2019 |
| U.S. Treasury securities | 100% | **11.26 %** | 9.04 % |
| Federal agency securities | 100% | **6.01 %** | 7.11 % |
| Asset-backed securities | 20% | **5.16 %** | — % |
| Supranationals | 30% | **6.13 %** | 2.82 % |
| Prime commercial paper | 25% | **7.46 %** | 9.04 % |
| Medium-term corporate notes | 30% | **15.31 %** | 25.63 % |
| Negotiable certificates of deposit | 30% | **10.82 %** | 16.27 % |
| Money Market Funds | 20% | **0.45 %** | 8.68 % |
| GSE | 20%[(1)] | **5.65 %** | 8.08 % |
| Municipal bonds | 30% | **0.35 %** | 0.24 % |
| CAMP | 30% | **23.67 %** | 5.70 % |
| LAIF | N/A | **7.73 %** | 7.39 % |
| Total portfolio | | **100.00 %** | 100.00 % |

[(1)] *Mortgage-backed securities included in GSE are limited to 100% of the investment portfolio in accordance with Metropolitan's investment policy.*

At September 30, 2020 and 2019, Metropolitan had the following investments (obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government not listed) representing five percent or more of its investments:

| (Dollars in thousands) | **2020** | | |
|---|---|---|---|
| CAMP | **$** | **229,657** | **23.67 %** |
| LAIF | **$** | **75,000** | **7.73 %** |

| (Dollars in thousands) | 2019 | | |
|---|---|---|---|
| LAIF | **$** | **65,000** | **7.39 %** |
| Federal National Mortgage Association[(1)] | **$** | **60,629** | **6.89 %** |
| CAMP | **$** | **50,117** | **5.70 %** |
| Federal Home Loan Bank[(1)] | **$** | **45,425** | **5.16 %** |

[(1)] *Invested in federal agency securities and GSEs*

***Custodial credit risk.*** At September 30, 2020 and 2019, Metropolitan's investments were insured, registered or held, in Metropolitan's name, in safekeeping at Metropolitan's bank, which was not a counterparty to the investment transactions. The exceptions were $229.7 million and $50.1 million in deposit in the CAMP and $75.0 million and $65.0 million in deposit in LAIF as of September 30, 2020 and 2019, respectively.

CAMP is a program created through a joint powers agency as a pooled short-term portfolio and cash management vehicle for California public agencies under California Government Code Section 53601(p). CAMP is governed by a seven member Board of Trustees comprised of finance directors and treasurers of California public agencies. The total amount invested by all public agencies in CAMP was $6.8 billion as of September 30, 2020, of which, 35.0 percent was invested in medium-term and short-term notes and asset-backed securities. The average maturity of CAMP investments was 40 days as of September 30, 2020.

The LAIF, created by California statute, is part of a pooled money investment account (PMIA). The LAIF has oversight by the Local Investment Advisory Board, which consists of five members designated by statute. The Chairwoman is the State Treasurer, or her designated representative.

The total amount invested by all public agencies in LAIF as of September 30, 2020 and 2019 was $32.4 billion and $24.5 billion, respectively. At September 30, 2020 and 2019, the PMIA had a balance of $109.2 billion and $97.4 billion, respectively, of which, 3.47 percent and 2.14 percent, respectively, were invested in medium-term and short-term notes and asset-backed securities. The average maturity of LAIF investments as of September 30, 2020 and 2019 was 169 days and 185 days, respectively.

### (c) Reverse Repurchase Agreements

Metropolitan is permitted, subject to conditions imposed by State law, to sell securities owned under written agreements and to buy back the securities on or before a specified date for a specified amount. No such reverse repurchase agreements were entered into during the twelve months ended September 30, 2020 and 2019.

### (d) Restricted Cash and Investments

Metropolitan has established a number of separate accounts, also referred to as funds, to provide for specific activities in accordance with special regulations, bond covenants, and trust arrangements. The accounts are classified as "restricted." Most restricted accounts have the minimum cash and investment balance requirements and all are nondiscretionary in terms of the use of assets. Among other things, the restricted amounts provide for payments of debt service on Metropolitan's bonds; reserves for principal and interest on outstanding bonds; payments for arbitrage tax rebate; construction of capital assets; payment of Metropolitan's operations and maintenance expenses; and payment of the costs related to the closure and postclosure maintenance of Metropolitan's solid waste landfill facility.

## 3. SHORT-TERM AND LONG-TERM DEBT

Metropolitan's enabling Act specifies that its indebtedness shall be limited to 15 percent of the assessed value of all taxable property within Metropolitan's service area. Existing outstanding debt of $4.279 billion and $4.208 billion at September 30, 2020 and 2019, respectively, represents less than one percent of the fiscal year 2021 and 2020 total taxable assessed valuation of $3,263 billion and $3,092 billion, respectively.

Metropolitan's long-term debt consists of general obligation and revenue bond issues as well as other obligations. The general obligation bonds are secured by Metropolitan's authority to levy ad valorem property taxes. The revenue bond obligations are special limited obligations of Metropolitan and are secured by a pledge of Metropolitan's net operating revenues. Such obligations contain certain restrictive covenants, with which Metropolitan has complied. Substantially all of the bond issues contain call provisions. Substantially all of the debt proceeds have been, and are expected to continue to be, utilized to fund new facilities, improvements and betterments, and to refund outstanding bonds.

### (a) Commercial Paper and Revolving Notes

Metropolitan may issue up to $200.0 million in commercial paper to fund a portion of its capital investment plan, as approved by Metropolitan's Board. There was no commercial paper issued through September 30, 2020 and 2019 and no commercial paper was outstanding at September 30, 2020 and 2019. Metropolitan may also issue other forms of short-term debt such as variable rate water revenue bonds and revolving notes (see Notes 3c and 3f).

On June 30, 2020, Metropolitan issued certain notes evidencing a draw of $35.6 million from the RBC Short Term Credit Facility for the purpose of refunding a portion of Metropolitan's then outstanding subordinate lien bonds. On July 1, 2020, the draw was refunded with proceeds of the Water Revenue Refunding Bonds, 2020 Series C.

A total of $46.8 million of revolving notes were outstanding at September 30, 2020 and 2019.

### (b) General Obligation Bonds

In 1966, voters authorized Metropolitan to incur up to $850.0 million of general obligation bond indebtedness to finance a portion of Metropolitan's capital investment plan. The original amounts, issued as Series A through H under the 1966 authorization, totaled $850.0 million. Metropolitan has refunded a portion of these general obligation bond issues through the issuance of refunding bonds. A total of $32.2 million and $48.0 million in general obligation refunding bonds were outstanding at September 30, 2020 and 2019, respectively.

The general obligation refunding bond issues include both serial and term bonds that mature in varying amounts through March 2037 at interest rates of 5.0 percent. The term bonds are subject to mandatory redemption prior to maturity. All general obligation bonds maturing on or after the earliest applicable call date are subject to optional redemption prior to maturity, callable on interest payment dates, and subject to early redemption.

### (c) Revenue Bonds

Pursuant to a 1974 voter authorization, additional funds, primarily for funding the capital investment plan, are obtained through the sale of water revenue bonds. Revenue bonds may be issued subject to certain conditions, including a requirement that the total of revenue bonds outstanding does not exceed the equity (net position) of Metropolitan as of the fiscal year end prior to such issuance. Metropolitan has refunded some of these revenue bonds through the issuance of refunding bonds. A total of $3.763 billion and $3.816 billion of revenue bonds and revenue refunding bonds were outstanding at September 30, 2020 and 2019, respectively.

Each fixed rate revenue and revenue refunding bond issue consists of either serial or term bonds or both that mature in varying amounts through October 2049 at interest rates ranging from 2.00 percent to 5.75 percent. The term bonds are subject to mandatory redemption prior to maturity. Substantially all revenue bonds maturing on or after the earliest applicable call date are subject to optional redemption prior to maturity, callable on any interest payment dates, and subject to early redemption.

Revenue Bond issued during the twelve months ended September 30, 2020 was as follows:

- On February 11, 2020, Metropolitan issued $207.3 million of Water Revenue Bonds, Series 2020 A, at a true interest cost of 3.05 percent, to prepay $100.0 million note drawn under the RBC Shot-Term Credit Facility, and to fund a portion of Metropolitan's Capital Investment Plan and costs of issuance. The maturities extend to October 1, 2049 and are subject to mandatory and optional provisions.

### (d) Bond Refundings and Defeasances

Metropolitan has issued Waterworks General Obligation Refunding Bonds, Water Revenue Refunding Bonds, Special Variable Rate Water Revenue Refunding Bonds, and short-term notes to refund various issues of Waterworks General Obligation Bonds, Waterworks General Obligation Refunding Bonds, Water Revenue Bonds, Water Revenue Refunding Bonds, Special Variable Rate Water Revenue Refunding Bonds, and revolving notes previously issued. The net proceeds from these sales were used to redeem the refunded bonds and fund certain swap termination payments or to purchase U.S. Treasury securities that were deposited in irrevocable escrow trust accounts with a bank acting as an independent fiscal agent to provide for all future debt service on the bonds being refunded. As a result, those bonds are considered defeased and the related liabilities have been excluded from Metropolitan's basic financial statements.

### (e) Interest Rate Swaps

Metropolitan has eight outstanding interest rate swap agreements as of September 30, 2020. These agreements require that Metropolitan pay fixed interest rates and receive interest at variable interest rates which are Metropolitan's hedging derivative instruments.

### Pay-Fixed, Receive-Variable

***Objective of the Swaps:*** In order to take advantage of low interest rates in the marketplace, Metropolitan entered into eight separate pay-fixed, receive-variable interest rate swaps at costs that were less than what Metropolitan otherwise would have paid to issue fixed rate debt in the tax-exempt municipal bond market.

***Terms:*** The notional amounts of the swaps match the principal amounts of the associated debt in total. Metropolitan's swap agreements contain scheduled reductions to outstanding notional amounts that are expected to approximately follow scheduled or anticipated reductions in the associated long-term debt.

***Fair Values:*** At September 30, 2020, all pay-fixed, receive-variable swaps had a negative fair value. Because the coupons on Metropolitan's variable rate bonds adjust to changing interest rates, the bonds do not have corresponding fair value changes. The fair values of the swaps were estimated using the zero-coupon method and exclude accrued interest. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement on the swaps.

***Credit Risks:*** As of September 30, 2020, Metropolitan was not exposed to credit risk on the outstanding pay-fixed, receive-variable swaps that had negative fair values. However, should interest rates change and the fair values of the swaps become positive, Metropolitan would be exposed to credit risk to each swap counterparty in the amount of the derivatives' fair value. Should the counterparties to the transactions fail to perform according to the terms of the swap contract, Metropolitan would face a maximum possible loss equal to the fair value of these swaps.

All swap agreements contain specific collateral requirements that are in effect for Metropolitan and the counterparties. The swaps require different collateral levels based on credit ratings and the fair value of the swap. Generally, the fair value threshold levels are also reduced as the credit ratings are reduced. Collateral on all swaps is to be in the form of U.S. government securities that may be held by the party posting the collateral. Metropolitan had no posted collateral as of September 30, 2020.

Each swap contains cross-default provisions that allow the nondefaulting party to accelerate and terminate all outstanding transactions and to net the transactions' fair values into a single sum to be owed by, or owed to, the nondefaulting party.

As of September 30, 2020, Metropolitan has pay-fixed, receive-variable swap transactions with one counterparty in the amount of $197.2 million or 44.9 percent of the notional amount of Metropolitan's outstanding pay-fixed, receive-variable swap transactions. This counterparty is rated Aa2/A+/AA by Moody's, Standard & Poor's Global, and Fitch Ratings, respectively.

***Basis Risk:*** The interest rates on Metropolitan's variable rate bonds are expected to be equivalent, but not necessarily equal to the variable rate payments received from counterparties on pay-fixed, receive-variable interest rate swaps. To the extent these variable payments differ, Metropolitan is exposed to basis risk. When the rates received from the counterparties are less than the rates on variable rate bonds associated with the respective swap transactions there is a basis loss. When the rates received from the counterparties are greater than the rates on variable rate bonds associated with the respective swap transactions there is a basis gain. As of September 30, 2020, the interest rates of the variable rate debt associated with these swap transactions range from .11 percent to .44 percent. Metropolitan's variable rate payments received from the counterparties of these swaps ranged from .09 percent to .16 percent.

***Termination Risk:*** Metropolitan may terminate any of the swaps if the other party fails to perform under the terms of the swap agreements. If any of the swaps are terminated, the associated variable rate bonds would no longer carry a synthetic fixed interest rate. Also, if at the time of termination the swap has a negative fair value, Metropolitan would be liable to the counterparty for a payment equal to the swap's fair value.

***Tax Risk:*** As with other forms of variable rate exposure and the relationship between the taxable and tax-exempt markets, Metropolitan is exposed to tax risk should tax-exempt interest rates on variable rate debt issued in conjunction with the swaps rise faster than taxable interest rates received by the swap counterparties, due particularly to reduced federal or state income tax rates, over the term of the swap agreement.

### (f) Variable Rate Bonds

The variable rate bonds bear interest at daily and weekly rates ranging from .11 percent to .47 percent as of September 30, 2020 and 1.10 percent to 2.34 percent as of September 30, 2019. Metropolitan can elect to change the interest rate period of the bonds with certain limitations.

Metropolitan has entered into standby bond purchase agreements (SBPA) with commercial banks to provide liquidity for six separate variable rate bond issues listed in the table below. Bondholders have the right to tender such variable rate bonds to the paying agent on any business day with same day notice. In the event that tendered bonds are not remarketed, the paying agent will draw on the SBPA to pay such bondholders. The draw on the SBPA creates a new debt obligation between Metropolitan and the Bank, called a Bank Bond.

The Bank Bonds that would be issued under the SBPA would initially bear interest at a per annum interest rate equal to, depending on the applicable SBPA, a Base Rate of either: (a) the highest of the (i) Prime Rate plus one percent, (ii) Federal Funds Rate plus two percent, and (iii) seven percent; or (b) the highest of the (i) Prime Rate, (ii) Federal Funds Rate plus one half of one percent, and (iii) seven and one half percent (with the Base Rate increasing in the case of each of (i), (ii) and (iii) of this clause (b) after 90 days, by one percent). To the extent such bank bonds have not been remarketed or otherwise retired as of the earlier of the 90th day following the draw on the SBPA or the stated expiration date of the related SBPA, Metropolitan's obligation to repay the principal of the Bank Bonds would be payable in semi-annual installments over a period of approximately three or five years, depending on the applicable SBPA. Metropolitan has secured its obligation to repay principal and interest under the SBPAs as a senior lien obligation.

In addition, such bonds are subject to mandatory tender for purchase under certain circumstances, including upon the expiration of the SBPA. Metropolitan intends to either renew the facility or exercise its right to remarket the debt as a long-term financing. The portion that would be due in the next fiscal year in the event that the outstanding variable rate bonds were tendered and purchased by the commercial banks under the standby agreements was $26.5 million and $45.3 million at September 30, 2020 and 2019, respectively.

Metropolitan has the following six variable rate bonds that are supported by a SBPA as of September 30, 2020 and 2019:

(Dollars in thousands)

| | Amount | | Expiration | Interest | Current Amount | |
|---|---|---|---|---|---|---|
| **Bond Issue** | **9/30/2020** | 9/30/2019 | **Date** | **Rate** | **9/30/2020** | 9/30/2019 |
| **Water Revenue Bonds** | | | | | | |
| 2000 Series B-3 | **$ 78,900** | $ 88,800 | 3/20/23 | Reset Daily | **$ —** | $ 88,800 |
| 2017 Series A | **80,000** | 80,000 | 3/20/23 | Reset Daily | **—** | 80,000 |
| **Water Revenue Refunding Bonds** | | | | | | |
| 2018 Series A-1, A-2 | **90,070** | 209,870 | 6/25/21 | Reset Daily | **90,070** | — |
| 2016 Series B-1, B-2 | **82,905** | 103,670 | 7/19/21 | Reset Daily | **82,905** | — |
| Total | **$ 331,875** | $ 482,340 | | | **$ 172,975** | $ 168,800 |

Metropolitan has the following eight variable rate bonds that are not supported by a SBPA as of September 30, 2020 and 2019:

(Dollars in thousands)

| **Bond Issue** | **9/30/20** | **9/30/19** | **Interest Rate** |
|---|---|---|---|
| **Water Revenue Refunding Bonds** | | | |
| 2013 Series D | **$ —** | $ 87,445 | Reset Weekly |
| 2014 Series D | **—** | 38,465 | Reset Weekly |
| 2015 Series A-1, A-2 | **—** | 188,900 | Reset Weekly |
| **Subordinate Water Revenue Bonds** | | | |
| 2016 Series A | **175,000** | 175,000 | 1M LIBOR plus % spread |
| 2017 Series C | **80,000** | 80,000 | SIFMA Index plus % spread |
| **Subordinate Water Revenue Refunding Bonds** | | | |
| 2017 Series D | **95,630** | 95,630 | SIFMA Index plus % spread |
| 2017 Series E | **95,625** | 95,625 | SIFMA Index plus % spread |
| Total | **$ 446,255** | $ 761,065 | |

The Subordinate Water Revenue Bonds, 2016 Series A were issued by Metropolitan through a Continuing Covenant Agreement with BANA (2016 BANA Agreement). The Subordinate 2016 Series A bonds will bear interest at a variable rate at a spread of 32 basis points to one-month LIBOR. The Subordinate 2016 Series A bonds are subject to mandatory tender for purchase on the scheduled mandatory tender date of December 21, 2020, or if directed by BANA upon the occurrence and continuance of an event of default under the 2016 BANA Agreement, five business days after receipt of such direction. A failure by Metropolitan to pay the purchase price of such bonds on the mandatory tender date would constitute an event of default under Metropolitan's Subordinate Debt Resolutions if not remedied within five business days. Metropolitan intends to either extend the 2016 BANA Agreement or remarket the bonds in the public debt market prior to the scheduled mandatory tender date. Metropolitan has secured its obligation to pay principal and interest under the 2016 BANA Agreement as a Subordinate Lien Parity Obligation.

The current terms of the Subordinate Water Revenue Refunding Bonds, 2017 Series D and Series E (SIFMA Index Mode), and the Subordinate Water Revenue Bonds, 2017 Series C (SIFMA Index Mode), require bondholders to tender their bonds for purchase on the scheduled mandatory tender date of June 21, 2021. A failure by Metropolitan to pay the purchase price from the proceeds of remarketing or other funds, for a period of five business days following written notice by any owner of such bonds, will constitute an event of default under Metropolitan's Subordinate Debt Resolutions. Upon the occurrence and continuance of such events of default, the owners of 25 percent in aggregate principal amount of the Subordinate Revenue Bonds then outstanding may elect a bondholders' committee to exercise rights and powers of such owners under the Subordinate Debt Resolutions, including the right to declare the entire unpaid principal of the Subordinate Revenue Bonds then outstanding to be immediately due and payable.

As of September 30, 2020 and 2019, the four series of variable rate self-liquidity bonds not supported by a SBPA but are covered by the RCA are as follows:

(Dollars in thousands)

| Bond Issue | Amount 9/30/20 | Amount 9/30/19 | Expiration Date | Interest Rate | Borrowing Amount 9/30/19 | Current Amount 9/30/20 | Current Amount 9/30/19 |
|---|---|---|---|---|---|---|---|
| **Water Revenue Refunding Bonds** | | | | | | | |
| 2013 Series D | $ — | $ 87,445 | 6/23/23 | Reset Weekly | $ 87,445 | $ — | $ — |
| 2014 Series D | — | 38,465 | 6/23/23 | Reset Weekly | 38,465 | — | — |
| 2015 Series A-1, A-2 | — | 188,900 | 6/23/23 | Reset Weekly | 74,090 | — | 114,810 |
| Total | $ — | $ 314,810 | | | $ 200,000 | $ — | $ 114,810 |

As of September 30, 2019, the four series of the variable rate self-liquidity bonds that were not supported by a SBPA had no long-term take out provisions therefore, the entire principal amount of $314.8 million, could be tendered for purchase upon one week's notice from bondholders. However, on June 25, 2018, Metropolitan entered into a RCA, under which Metropolitan could borrow up to $200.0 million, to pay the purchase price (principal and accrued interest) of any self-liquidity bonds tendered for purchase. Borrowings made by Metropolitan under the RCA initially bear interest at a fluctuating per annum interest rate equal to, at Metropolitan's discretion, either: (a) one month LIBOR plus one and a half percent; or (b) the higher of (i) the Federal Funds Rate plus one half of one percent, and (ii) the Prime Rate (increasing in any case periodically, beginning after 90 days). The RCA permitted repayment of any borrowed principal funds over ten semi-annual installments beginning 180 days after the funds are borrowed. The RCA had a stated expiration date of June 23, 2023. As a result of the RCA, $114.8 million was reported as current liabilities as of September 30, 2019. On April 3, 2020, the four series of variable rate self-liquidity bonds were refunded and on April 17, 2020, Metropolitan terminated the RCA.

## 4. PENSION PLAN

### (a) General Information about the Pension Plan

### Plan Description

All full-time Metropolitan employees are required to participate in Metropolitan's Miscellaneous Plan with CalPERS, an agent multiple-employer public employee defined benefit pension plan. CalPERS acts as a common investment and administrative agent for participating public entities within the State of California. A menu of benefit provisions as well as other requirements is established by State statutes within the Public Employee's Retirement Law. Metropolitan selects optional benefit provisions from the benefit menu by contract with CalPERS and adopts those benefits through Board approval. CalPERS issues a separate comprehensive annual report. Copies of CalPERS' annual financial report may be obtained from its Executive Office, 400 Q Street, Sacramento, CA 95811.

### Benefits Provided

CalPERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. Benefits are based on years of credited service, equal to one year of full-time employment. Employees hired prior to January 1, 2013 (Classic members) with five years of total service are eligible to retire at age 50 with statutorily reduced benefits; employees hired after January 1, 2013 (PEPRA members) with at least five years of credited service are eligible to retire at age 52 with statutorily reduced benefits. All members are eligible for improved non-industrial disability benefits after five years of service. The death benefit is one of the following: the Basic Death Benefit, the 1959 Survivor Benefit, or the Optional Settlement 2W Death Benefit.

## 5. POSTEMPLOYMENT BENEFITS OTHER THAN PENSIONS (OPEB)

### (a) Plan Description and Benefits Provided

Through CalPERS, Metropolitan offers medical insurance to active and retired employees, as well as their qualified dependents under the Public Employees' Medical and Hospital Care Act (PEMHCA). Under PEMHCA, health coverage for the employee continues into retirement. Current plans offered are PERS Care PPO, PERS Choice PPO, PERS Select PPO, Blue Shield HMO, and Kaiser HMO. Metropolitan participates in the CERBT Fund, which is an agent multiple-employer plan available to employers to pre-fund OPEB benefits. Benefit provisions are established through negotiations between Metropolitan and its various bargaining units, which also apply to retirees. For employees hired on or after January 1, 2012, retirees must have a minimum of 10 years of PERS service and no less than five years of Metropolitan service in order to receive post-employment health benefits in accordance with PERS as per Government Code Section 22893. For employees hired prior to January 1, 2012, retirees are not required to meet the eligibility criteria. CalPERS issues a separate comprehensive annual report that includes financial statements for its CERBT Fund. Copies of CalPERS' annual financial report may be obtained from its Executive Office, 400 Q Street, Sacramento, CA 95811.

## 6. COMMITMENTS AND CONTINGENCIES

### (a) State Water Contract (see Note 7)

Estimates of Metropolitan's share of the projected fixed costs of the SWP are provided annually by the State. The estimates are subject to future increases or decreases resulting from changes in planned facilities, refinements in cost estimates, and inflation. During the next five years, payments under the State Water Contract, exclusive of variable power costs, are currently estimated by the State to be as follows:

| (Dollars in thousands) | State Water Contract Payments |
|---|---|
| Year ending June 30: | |
| 2021 | $ 469,187 |
| 2022 | 480,909 |
| 2023 | 496,922 |
| 2024 | 495,033 |
| 2025 | 504,279 |

Metropolitan intends to exercise its option to extend its agreement with the State through 2085, which will result in annual minimum operations and maintenance costs through 2085. In addition, the amounts shown above do not contain any escalation for inflation, are subject to significant variation over time because the amounts are based on a number of assumptions, and are contingent on future events. None of the estimated long-term commitments are recorded as liabilities in the accompanying basic financial statements.

### (b) Bay/Delta Regulatory and Planning Activities

The State Water Resources Control Board (State Board) is the agency responsible for setting water quality standards and administering water rights throughout California. Decisions of the State Board can affect the availability of water to Metropolitan and other water users throughout California. The State Board exercises its regulatory authority over Bay/Delta watershed supplies by means of public proceedings leading to regulations and decisions.

In September 2006, then Governor Schwarzenegger established a Delta Vision Process to identify a strategy for managing the Delta as a sustainable resource. The process was tied to legislation that created a Blue Ribbon Task Force (BRTF) and cabinet-level committee tasked with developing a durable vision for sustainable management of the Delta over the long-term which addressed a full array of issues, including land use, infrastructure, flood protection, and natural resources including water supply. The BRTF released its final Delta Vision Strategic Plan in October 2008 and a final implementation report was submitted to the Governor in January 2009. Subsequently, the Delta Reform Act of 2009 was enacted, which created the Delta Stewardship Council (DSC), a seven member appointed body charged with developing a Delta Plan to support carrying out the Delta Vision, which the DSC completed on September 1, 2013. The Delta Plan anticipated the need for periodic reviews and updates in response to changing circumstances and conditions in the Delta. The DSC amended the Delta Plan in February 2016 to include an initial set of performance measures in September 2016 to exempt single-year water transfers from consideration as covered actions. DSC adopted three amendments to the Delta Plan in April 2018. The Preliminary

Draft Amendment to Chapter 4 (Ecosystem) was released in November 2019. The DSC anticipates the adoption of the amendment in 2021.

To avoid endangering State or federally listed species or adversely modifying their critical habitat, the Department of Water Resources consults with the California Department of Fish and Wildlife Service (CDFW) or its federal agency counterparts under the California Endangered Species Act (ESA) and federal ESA regarding the operation of the SWP. If a project may adversely affect a listed species, a formal consultation is held with the state and federal regulatory agencies. The regulatory agency(ies) then issue operating permits under the ESA jurisdiction, a federal biological opinion and a State Incidental Take Permit (ITP). Updated federal biological opinions were approved in February 2020 and a State ITP was issued by CDFW in March 2020. Both the federal and state permits have subsequently been challenged in court by multiple parties including water agencies and non-governmental organization groups. Metropolitan is involved in the federal permit litigation as part of the State Water Contractors, and in the State ITP litigation as Metropolitan, in order to protect its interests that the permits be based on the best available science.

The Bay Delta Conservation Plan (BDCP), which began in 2007, is a voluntary collaboration of state, federal, and local water agencies, state and federal fish agencies, environmental organizations, and other interested parties to provide a comprehensive habitat conservation and restoration program for the Delta. In addition, the BDCP would provide the basis for permits under federal and state endangered species laws for activities covered by the plan based on the best available science, identified sources of funding, and an adaptive management and monitoring program. On April 30, 2015, the state announced its intent to include new alternatives separating the conveyance facilities and habitat restoration measures into two separate permitting efforts namely: California WaterFix (CWF) and California EcoRestore. Under the CWF, the new water conveyance facilities with proposed design changes would be constructed and operated. On February 12, 2019, Governor Newsom announced the shift to a single tunnel project now referred to as the Delta Conveyance Project.

A final decision regarding whether to approve the proposed Delta Conveyance Project or an alternative, including the no project alternative, will not occur until after completion of the environmental review under the California Environmental Quality Act and the National Environmental Policy Act (NEPA), and other environmental permitting processes have been completed. The U.S. Army Corps of Engineers (USACE) issued a Notice of Intent (NOI) for the development of an Environmental Impact Statement for the Delta Conveyance Project on August 20. Publication of the NOI initiates the environmental review process under NEPA. The NOI also signals the start of the federal scoping period, providing an opportunity for public and agency comment on the scope and content of the NEPA review.

### (c) Imperial Irrigation District

As of September 30, 2020, Metropolitan had advanced a total of $357.4 million to the Imperial Irrigation District (IID) for construction costs, operations and maintenance costs, and indirect costs of the conservation projects. Metropolitan remains obligated to pay IID for actual operation and maintenance costs for the remainder of this agreement through at least 2041. In return, Metropolitan will receive between 85.0 TAF to 105.0 TAF in 2020 and annually thereafter depending upon the amount used by the Coachella Valley Water District (CVWD). A total of at least 85.0 TAF and up to 105.0 TAF will be/was available in calendar years 2020 and 2019, respectively, for diversion by Metropolitan.

### (d) Sale of Water by the Imperial Irrigation District to San Diego County Water Authority

In April 1998, the San Diego County Water Authority (SDCWA) and IID executed an agreement (Transfer Agreement) for SDCWA's purchase from IID of Colorado River water that is conserved within IID. SDCWA is a Metropolitan member agency and one of the largest water purchasers from Metropolitan. In October 2003 the Transfer Agreement was revised as part of the Quantification Settlement Agreement (see Note 6e). The amended Transfer Agreement sets the maximum transfer amount at 205.0 TAF in 2021, with the transfer gradually ramping up to that amount over an approximately twenty-year period, stabilizing at 200.0 TAF per year beginning in 2023.

No facilities exist to provide for delivery of water from IID to SDCWA. In 1998, Metropolitan and SDCWA entered into an agreement for the exchange of the IID water to be acquired by SDCWA under the Transfer Agreement, with water to be delivered by Metropolitan. In 2003, the boards of directors of Metropolitan and SDCWA agreed to an increase in the price that SDCWA would pay to Metropolitan for this exchange of water, in return for Metropolitan's assignment to SDCWA of Metropolitan's rights to water conserved as a result of the lining of the All-American and Coachella Canals and $235.0 million, as set forth in an amended exchange agreement (Exchange Agreement) and an Allocation Agreement. Under the Exchange Agreement, SDCWA makes available to Metropolitan at its intake at Lake Havasu on the Colorado River the conserved Colorado River water acquired by SDCWA from IID and the conserved canal lining water allocated to SDCWA. In exchange, Metropolitan delivers an equal volume of water from its own sources of supply through its delivery system to SDCWA. The deliveries to both Metropolitan and SDCWA are deemed to be made in equal monthly increments. SDCWA pays Metropolitan a volumetric price for each delivery by Metropolitan. The price payable by SDCWA is calculated using the charges set by Metropolitan's Board from time to time to be paid by its member agencies for the conveyance of water through Metropolitan's facilities (see Note 1c). SDCWA has challenged the validity of Metropolitan's charges for conveyance of water that became effective January 1, 2011 and January 1, 2012, in San Diego County Water Authority v. Metropolitan Water District of Southern California; et al. On June 8, 2012, SDCWA filed a separate lawsuit challenging the rates adopted by Metropolitan's Board on April 10, 2012 and effective on January 1, 2013 and January 1, 2014. On May 30, 2014, SDCWA filed a separate lawsuit challenging the rates adopted by Metropolitan's Board on April 8, 2014 and effective on January 1, 2015 and January 1, 2016. On April 13, 2016, SDCWA filed a separate lawsuit challenging the rates and charges adopted by Metropolitan's Board on April 12, 2016 and effective on January 1, 2017 and January 1, 2018. On June 8, 2018, SDCWA filed a separate lawsuit challenging the rates and charges adopted by Metropolitan's Board on April 10, 2018 and effective on January 1, 2019 and January 1, 2020. The Exchange Agreement requires Metropolitan to pay the disputed portion of the amount paid by SDCWA under the Exchange Agreement and interest thereon to SDCWA, if SDCWA prevails in a dispute over the price payable by SDCWA under the Exchange Agreement. See Claims and Litigation, Note 6g.

### (e) Quantification Settlement Agreement

The Quantification Settlement Agreement (QSA) is part of the California Plan, which is a plan to reduce California's use of Colorado River water to its basic apportionment of 4.4 million acre-feet per year when necessary through water conservation, transfers from higher priority agricultural users to Metropolitan's service area, and storage programs. The QSA was executed in October 2003 and establishes Colorado River water use limits for IID and the CVWD. It also provides for specific acquisitions of conserved water and water supply arrangements and restores the opportunity for Metropolitan to receive any special surplus water.

### (f) Construction Programs and Contracts

The estimated cost, excluding contingencies, of Metropolitan's capital program for fiscal years 2021 through 2025 totals approximately $1.4 billion. However, due to various uncertainties such as lower than anticipated construction bids, permitting delays, and facility shutdown constraints, capital spending is forecasted at $200.0 million for fiscal year 2021, $225.0 million for fiscal year 2022 and $300.0 million per year for fiscal year 2023 through 2025.

Over the next three years, Capital Investment Plan budget totals approximately $800.0 million with over $157.1 million targeted for mechanical and electrical refurbishment and replacement (R&R) projects for the Colorado River Aqueduct; $120.5 million for R&R work at Metropolitan's water treatment plants; $122.9 million on a variety of information technology projects such as the Supervisory Control and Data Acquisition system, plus several security and support building improvements including the ongoing structural upgrades to the Los Angeles headquarters building; $106.4 million on R&R work at pressure control facilities and pipelines throughout the distribution system; and $108.7 million to continue relining of the Prestressed Concrete Cylinder Pipe portions of the Allen McColloch and Rialto Pipelines, and Calabasas, Second Lower, and Sepulveda feeders.

### (g) Claims and Litigation

SDCWA filed San Diego County Water Authority v. Metropolitan Water District of Southern California, et al. on June 11, 2010. The complaint alleges that the rates adopted by the Board on April 13, 2010, which became effective January 1, 2011 and January 1, 2012, misallocate certain State Water Contract costs to the System Access Rate and the System Power Rate, and thus affect charges for transportation of water, resulting in an overcharge to SDCWA by at least $24.5 million per year. The complaint alleges that all SWP costs should be allocated instead to Metropolitan's Supply Rate, even though under the State Water Contract Metropolitan is billed separately for transportation, power and supply costs. It states additionally that Metropolitan will overcharge SDCWA by another $5.4 million per year by including the Water Stewardship Rate in transportation charges.

The complaint requested a court order invalidating the rates adopted April 13, 2010, and that Metropolitan be mandated to allocate costs associated with the State Water Contract and the Water Stewardship Rate to water supply rates and not to transportation rates. Rates in effect in prior years are not challenged in this lawsuit. SDCWA filed its First Amended Petition for Writ of Mandate and Complaint on October 27, 2011, adding five new claims to this litigation, two of which were eliminated from the case on January 4, 2012. The three remaining new claims were for breach of the water Exchange Agreement between Metropolitan and SDCWA (see Note 6d) due to a price based on allegedly illegal rates; improper exclusion of SDCWA's payments under such Exchange Agreement from calculation of SDCWA's preferential rights to purchase Metropolitan supplies; and illegality of the rate structure integrity provision in conservation and local resources incentive agreements between Metropolitan and SDCWA. The rate structure integrity provision permitted the Board to terminate incentives payable under conservation and local resources incentive agreements between Metropolitan and a member agency due to certain actions by the member agency to challenge the rates that are the source of incentive payments. In June 2011, Metropolitan's Board authorized termination of two incentive agreements with SDCWA under the rate structure integrity provision in such agreements after SDCWA filed its initial complaint challenging Metropolitan's rates. SDCWA filed a Second Amended Petition for Writ of Mandate and Complaint on April 17, 2012, which contained additional allegations but no new causes of action.

On June 8, 2012, SDCWA filed a new lawsuit challenging the rates adopted by Metropolitan on April 10, 2012 and effective on January 1, 2013 and January 1, 2014. The complaint contained allegations similar to those in the Second Amended Petition for Writ of Mandate and Complaint and new allegations asserting that Metropolitan's rates, adopted in April 2012, violate Proposition 26. SDCWA filed a Third Amended Petition for Writ of Mandate and Complaint on January 23, 2013, to add new allegations that Metropolitan's rates adopted in April 2010 did not meet the requirements of Proposition 26. The court granted Metropolitan's motion to strike allegations relating to Proposition 26 on March 29, 2013, expressly ruling that SDCWA may not allege a violation of Proposition 26 in its challenge to the rates adopted in April 2010. This ruling did not affect SDCWA's separate challenge to Metropolitan's rates adopted in April 2012, which also includes Proposition 26 allegations.

Following trial of both lawsuits in two phases, concluding on January 23, 2014 and April 30, 2015, respectively, the Superior Court of the State of California, County of San Francisco (the "Superior Court"), issued its Final Judgment and a Peremptory Writ of Mandate in the 2010 and 2012 SDCWA v. Metropolitan cases. Metropolitan appealed the trial court's decision in each case, and SDCWA filed a cross-appeal of the court's ruling on the rate structure integrity claim and an attorneys' fees order.

On June 21, 2017, the California Court of Appeal released its decision in the appeals and cross-appeal filed by Metropolitan and SDCWA, respectively. The Court of Appeal ruled that Metropolitan may lawfully include its SWP transportation costs in the System Access Rate and System Power Rate that are part of the Exchange Agreement's price term, and that Metropolitan may also lawfully include the System Access Rate in its wheeling rate, reversing the trial court decision on this issue. The Court held Metropolitan's allocation of the SWP transportation costs as its own transportation costs is proper and does not violate the wheeling statutes (Water Code, § 1810, et seq.), Proposition 26 (Cal. Const., Article XIIIC, §1, subd.(e)), whether or not that Proposition applies to Metropolitan's rates, California Government Code section 54999.7, the common law, or the terms of the parties' Exchange Agreement.

The Court of Appeal also ruled that the administrative record before it for the rates in calendar years 2011 through 2014 did not support Metropolitan's inclusion of its Water Stewardship Rate as a transportation cost in the Exchange Agreement price or the wheeling rate, under the common law and wheeling statutes. Having made that determination, the Court of Appeal stated it need not evaluate the issue under any other law. The court did not address the allocation of the Water Stewardship Rate in subsequent years based on a different record. The court noted, and in a subsequent modification confirmed, that its holding does not preclude Metropolitan from including the Water Stewardship Rate in Metropolitan's full service rate.

The Court of Appeal held that because the Water Stewardship Rate was included in the Exchange Agreement price, there was a breach by Metropolitan of the Exchange Agreement in 2011 through 2014. The court remanded the case to the trial court for a redetermination of damages in light of its ruling concerning the Water Stewardship Rate. The Court of Appeal agreed with the trial court that statutory prejudgment interest applies with respect to any damages award, not a lesser contractual interest. The Court of Appeal reversed the trial court by finding that the Exchange Agreement may entitle SDCWA to attorneys' fees for the second phase of the case concerning breach of contract; but directed the trial court on remand to make a new determination of the prevailing party, if any. The cases were therefore remanded to the trial court for a review of both damages and attorneys' fees.

With respect to other issues considered on appeal, the Court of Appeal upheld the trial court's ruling that Metropolitan improperly excludes SDCWA's payments under the Exchange Agreement in Metropolitan's calculation of SDCWA's preferential rights. The court also ruled that SDCWA had the constitutional right to challenge the rate structure integrity provision in Metropolitan's conservation and local resources incentive agreements and found that the rate structure integrity provision was invalid and unenforceable as an unconstitutional condition on the provision of a public benefit.

On September 27, 2017, the California Supreme Court denied SDCWA's petition for review, declining to consider the Court of Appeal's decision. The Court of Appeal's decision is therefore final.

On July 25, 2018, the Superior Court issued an order regarding the scope of the matters to be reconsidered by the Superior Court on remand pursuant to the Court of Appeal decision. With respect to the Superior Court's re-determination of damages in light of the Court of Appeal's ruling that the administrative record for calendar years 2011 through 2014 did not support Metropolitan's inclusion of its demand management costs in the Exchange Agreement price, the Superior Court ruled that it will award SDCWA $28,678,190.90 in contract damages for breach of the Exchange Agreement, plus prejudgment interest at 10 percent per annum. The Superior Court determined that Metropolitan is not entitled in the remand proceedings to show what it could have lawfully charged SDCWA for demand management costs and to deduct that from SDCWA's damages.

The Superior Court further ruled that SDCWA is not entitled in the remand proceedings to litigate the issue of "offsetting benefits" under the wheeling statutes for the parties' Exchange Agreement. The Superior Court found that such claim is both outside the scope of remand and waived.

The Superior Court also ruled that SDCWA is entitled to judgment on its declaratory relief cause of action declaring the rate structure integrity provision in Metropolitan's conservation and local resources incentive agreements invalid and unenforceable, SDCWA is entitled to further proceedings to litigate the issue of an entitlement to monetary restitution for 2011 through 2014, and the parties shall also litigate in further proceedings the issue of what prospective relief SDCWA may be entitled to in connection with this cause of action.

Finally, the Superior Court confirmed, as the parties agreed, that it will conduct further proceedings for a redetermination of the prevailing party and attorneys' fees in this matter.

On September 14, 2018, Metropolitan filed a Petition for Writ of Mandate with the California Court of Appeal, requesting the court to require the Superior Court to recalculate contract damages for breach of the Exchange Agreement from years 2011 through 2014, to include a set-off for the additional sums SDCWA would have paid had Metropolitan collected the Water Stewardship Rate through its full service sales as SDCWA argued was correct. On

November 1, 2018, the Court of Appeal determined that it would not review the issue at this stage of the cases. Metropolitan may raise this issue again on any later appeal from the cases' final judgment.

Due to SDCWA's litigation challenging Metropolitan's rates, and pursuant to the Exchange Agreement between Metropolitan and SDCWA, as of September 30, 2020, Metropolitan held $58.3 million in a designated fund, the Exchange Agreement Set-Aside Fund. This amount includes the disputed Water Stewardship Rate payments for calendar years 2011 through 2017, and interest earned by Metropolitan thereon. The amount held does not include statutory prejudgment interest or any post-judgment interest, attorneys' fees, or costs the Court may award.

On February 14, 2019, Metropolitan tendered to SDCWA payment of $44.4 million for the San Francisco Superior Court's contract damages award for Water Stewardship Rate payments from 2011 through 2014, plus statutory interest through February 15, 2019, with a reservation of appeal rights, in the San Diego County Water Authority v. Metropolitan Water District of Southern California, et al., 2010 and 2012 actions. This tender was made under compulsion to cease accrual of statutory interest in excess of market rates, but did not affect Metropolitan's rights to appeal, including its right to challenge the amount of the damages award. The tendered payment included $31.6 million of amounts withdrawn from the Exchange Agreement Set-Aside Fund, and $12.8 million withdrawn from reserves (representing statutory interest). On March 7, 2019, SDCWA rejected the tendered payment and returned the uncashed check for the tendered payment. The returned funds were credited back to the Exchange Agreement Set-Aside Fund and Metropolitan reserves in the amounts drawn. The balance in the Exchange Agreement Set-Aside Fund set forth above includes the returned funds. In the 2010-2012 Judgment (discussed below), the Superior Court confirmed that Metropolitan's tender was effective and stopped the accrual of interest in February 2019.

On August 29, 2019, as a result of changes in reorganization of assignments at the San Francisco Superior Court, the 2010, 2012, 2016, and 2017 SDCWA v. Metropolitan cases were reassigned to a different department of the Court. SDCWA filed a motion for peremptory disqualification of the new judge and on September 6, 2019, the motion was sustained. On September 27, 2019, the 2010, 2012, 2016, and 2017 cases were assigned to Department 304, a different complex department in which the 2014 case is already pending.

The Superior Court had scheduled an evidentiary hearing for June 16 to June 18, 2020 on SDCWA's requested relief based on its rate structure integrity provision claim. Following action of the SDCWA Board of Directors on February 27, 2020 (discussed below), SDCWA informed Metropolitan and the court that it was no longer seeking this relief. Accordingly, the evidentiary hearing was canceled. .

On August 13, 2020, the Superior Court entered a final judgment in the 2010 and 2012 SDCWA v. Metropolitan cases (the "2010-2012 Judgment"). On August 14, 2020, SDCWA served notice of entry of judgment and notice of the court's peremptory writ of mandate in the cases.

In the 2010-2012 Judgment, the Court entered judgment: (1) on the first three causes of action – for writ of mandate, declaratory relief, and invalidation (the rate challenges) – in SDCWA's favor, because the Court of Appeal found Metropolitan's inclusion of the Water Stewardship Rate as a component of the transportation rates charged under the

Exchange Agreement and wheeling rate was unlawful, and ordered issuance of a writ of mandate as described below; (2) on the fourth cause of action – breach of contract – in favor of SDCWA but only with respect to its challenge to Metropolitan's inclusion of the Water Stewardship Rate in the Exchange Agreement price for deliveries in 2011-2014, the Court awarded San Diego a total of $44,373,872.29, comprised of: (A) $28,678,190.90 in damages; (B) prejudgment interest at the rate of 10 percent per annum through November 18, 2015 in the amount of $7,484,315.54; and (C) post-judgment interest at the rate of 7 percent per annum from November 19, 2015 until February 15, 2019 (the date of Metropolitan's tender of $44,373,872.29 to San Diego), in the amount of $8,211,365.85; (3) on the fifth cause of action – declaratory relief regarding the Rate Structure Integrity (RSI) provision – in favor of SDCWA as the RSI provision is invalid and unenforceable; (4) on the sixth cause of action – declaratory relief regarding preferential rights calculation – in favor of SDCWA that Metropolitan's previous methodology for calculating preferential rights violates § 135 of the Metropolitan Water District Act; (5) on the previously-dismissed cause of action for breach of fiduciary duty – in favor of Metropolitan; and (6) on the previously dismissed cause of action for breach of the covenant of good faith and fair dealing – in favor of Metropolitan.

The peremptory writ of mandate commands Metropolitan to "enact only legal wheeling and transportation rates in the future and, specifically, not to do the things that [the Court of Appeal] held were unlawful," and incorporates by reference the Court of Appeal decision; and to "exclude the costs of conservation programs and other demand management programs, enacted in [the 2010 and 2012] cases as the Water Stewardship Rate, from Metropolitan's wheeling rate published in Section 4405 of Metropolitan's Administrative Code and from the transportation rates charged under the [Exchange Agreement]."

Metropolitan filed a notice of appeal of the 2010-2012 Judgment and the writ on September 11, 2020.

The court has requested the parties' briefing as to whether it has jurisdiction to determine the prevailing party, if any, in the 2010 and 2012 cases, after the appeal was filed. If so, on December 16, 2020, the court will hear cross-motions on the determination of a prevailing party, if any, under the Exchange Agreement's attorneys' fees and costs provision, and thereafter will conduct further proceedings on fees. On January 12, 2021, the court will hear Metropolitan's motion to strike SDCWA's memorandum of costs, and SDCWA's motion to strike or tax Metropolitan's memorandum of costs, which also involve a determination of prevailing party. Metropolitan contends that it is the prevailing party entitled to attorneys' fees and costs, or else there is not a prevailing party in these mixed-result cases. The determinations as to any prevailing party, attorneys' fees, and costs will also be subject to appeal after entry of the final order.

In May 2014, SDCWA filed a new lawsuit asserting essentially the same rate claims and breach of contract claim in connection with the Board's April 2014 rate adoption. Metropolitan filed its answer on June 30, 2014. On February 9, 2015, pursuant to stipulation by the parties, the San Francisco Superior Court ordered that the case be stayed. Metropolitan is unable to assess at this time the likelihood of success of this case, any possible appeal or any future claims.

On April 13, 2016, SDCWA filed a new lawsuit that alleged all rates and charges for 2017 and 2018 adopted by Metropolitan's Board on April 12, 2016 violate the California Constitution, statutes, and common law. The Petition for Writ of Mandate and Complaint asserted misallocation of costs as alleged in the previous cases listed above and additional claims of over-collection and misallocation of costs and procedural violations. Following a stipulated order issued by the court on November 10, 2016, SDCWA filed a First Amended Petition for Writ of Mandate and Complaint and the court ordered the case stayed pending final resolution of the 2010 and 2012 SDCWA v. Metropolitan cases' appeals. The amended petition/complaint added allegations of the same Exchange Agreement breach as in the previous cases listed above and breach of a provision that requires Metropolitan to set aside disputed amounts, relating to the manner in which Metropolitan has set aside the amounts; requested a judicial declaration that, if a judgment is owed to SDCWA under the Exchange Agreement, SDCWA will not be required to pay any portion of that judgment; and requested a refund to SDCWA of any amount Metropolitan has collected in excess of the reasonable costs of the services provided or, alternatively, a reduction in SDCWA's future fees.

On August 27, 2020, the court granted SDCWA's motion to lift the stays in the 2014 and 2016 SDCWA v. Metropolitan cases and to file a further amended petition/complaint. On August 28, 2020, SDCWA filed the amended petitions/complaints, which included claims for offsetting benefits. On September 28, 2020, Metropolitan filed demurrers to, or in the alternative motions to strike, portions of the amended petitions/complaints, which are set for hearing on February 10, 2021. The pleadings seek to remove offsetting benefits claims in both cases as to alleged breach of contract and Metropolitan's wheeling rate, and the declaratory relief claim in the 2016 case as to how Metropolitan may satisfy a judgment.

On June 9, 2017, SDCWA filed a new Petition for Writ of Mandate and Complaint challenging the Readiness-to-Serve Charge and Capacity Charge for 2018 adopted by Metropolitan's Board on April 11, 2017. These two charges are set annually, and SDCWA's 2016 lawsuit included a challenge to these two charges for 2017. The new lawsuit similarly alleged the 2018 Readiness-to-Serve Charge and Capacity Charge violate the California Constitution, statutes, and common law. The petition/complaint asserted misallocation of costs. Metropolitan was served with the petition/complaint on June 20, 2017. On July 18, 2017, SDCWA filed a first amended petition/complaint to add Metropolitan's Board action of July 11, 2017 to make minor corrections to the Readiness-to-Serve Charge. On July 31, 2018, pursuant to stipulation by the parties, the San Francisco Superior Court ordered that the case be stayed. On July 23, 2020, the court entered SDCWA's requested dismissal of the 2017 case. The dismissal is without prejudice, which means SDCWA would not be precluded from re-initiating the case in the future.

On June 8, 2018, SDCWA filed a new lawsuit that alleges all rates and charges for 2019 and 2020 adopted by Metropolitan's Board on April 10, 2018 violate the California Constitution, statutes, and common law. The Petition for Writ of Mandate and Complaint asserts the Water Stewardship Rate is unlawful per se and its collection in transportation charges is also unlawful; failure to provide wheelers a reasonable credit for "offsetting benefits" pursuant to Water Code Section 1810, et seq., which SDCWA contends (and Metropolitan disputes) applies to the parties' Exchange Agreement; over-collection and misallocation of costs, including misallocation of Metropolitan's California WaterFix costs as its transportation costs; and specified procedural violations. SDCWA states in the Petition and Complaint that it intends to amend its complaint to allege additional claims against Metropolitan, including but not limited to a claim for breach of contract. Following a stipulated order issued by the San Francisco Superior Court on January 10, 2019, SDCWA filed a First Amended Petition for Writ of Mandate and Complaint and the court ordered the case stayed pending final resolution of the 2010 and 2012 SDCWA v. Metropolitan cases. The amended petition/complaint adds a cause of action for breach of the Exchange Agreement alleging Metropolitan charged an unlawful price that includes the Water Stewardship Rate (despite suspension of this charge), failing to provide credit for offsetting benefits, charging transportation rates that are not based on costs of service, including California WaterFix costs, and not following procedural requirements; and requests a refund to SDCWA of any amount Metropolitan has collected in excess of the reasonable costs of the services provided or, alternatively, a reduction in SDCWA's future fees. On July 28, 2020, the parties filed a stipulation and application to designate the case complex and related to the 2010-2017 cases, and to assign the case to Department 304 in the San Francisco Superior Court, but the case remains unassigned. Metropolitan is unable to assess at this time the likelihood of success of this case, any possible appeal or any future claims.

On November 15, 2019, Metropolitan provided a statutory Offer to Compromise to SDCWA to resolve all pending litigation filed by SDCWA. The offer, which was not confidential, was made under California Code of Civil Procedure Section 998, and was deemed withdrawn if not accepted by December 30, 2019. By letter dated December 19, 2019, SDCWA notified Metropolitan that it had determined not to act upon Metropolitan's Section 998 Offer to Compromise. Metropolitan's statutory Offer to Compromise is now deemed withdrawn. SDCWA made its own settlement offer, which is public but non-statutory. SDCWA's settlement offer was made subject to acceptance by Metropolitan no later than the close of business on January 31, 2020. The Metropolitan Board reviewed SDCWA's proposal at its January 14, 2020 Board meeting and took no action.

On February 27, 2020, the SDCWA Board of Directors authorized its attorneys to dismiss, without prejudice, claims related to payments of the Water Stewardship Rate on supply purchases only and the unquantified claims in the stayed cases relating to cost-of-service grounds and the rate model. The above-mentioned amended petitions/complaints in the 2014 and 2016 cases added, removed, and retained certain claims. Retained claims include SDCWA's challenge to Metropolitan's Water Stewardship Rate for calendar years 2015 through 2018 based on its allocation to transportation, with a request for the court to invalidate the transportation rates and the wheeling rate and award damages for breach of the parties' Exchange Agreement as a result. Added claims include a challenge to the wheeling rate and alleged breach of the Exchange Agreement for failure to provide offsetting benefits (only the stayed 2018 case had previously included an offsetting benefits claim). SDCWA has not yet dismissed claims in the 2018 case. Metropolitan has not yet assessed the impact of the authorized dismissals. Metropolitan is unable to assess at this time the likelihood of success of these cases, any possible appeals or any future claims.

### (h) Drinking Water Quality Standards

Under the Safe Drinking Water Act Amendments of 1996, Congress required the United States Environmental Protection Agency to set new drinking water quality standards. New standards to control microbial pathogens and disinfection byproducts (DBPs) became effective in 2002. These rules are known as the Interim Enhanced Surface Water Treatment Rule and the Stage 1 Disinfectants/Disinfection By-Product Rule. These standards became more stringent in a second set of regulations effective 2006. The second set of regulations (the Stage 2 Disinfectants/Disinfection Byproducts Rule and the Long-Term 2 Enhanced Surface Water Treatment Rule) did not require additional capital investment by Metropolitan.

Metropolitan identified ozone disinfection as the most cost-effective option to minimize the production of DBPs and achieve other water quality objectives. Ozone is now used as the primary disinfectant at Diemer, Jensen, Mills, Skinner and Weymouth plants. The cost of implementing ozone treatment at all five plants was approximately $1.1 billion.

### (i) Reid Gardner Generating Station

Reid Gardner Generating Station (Plant) is a 557 megawatt coal-fired plant located near Moapa, Nevada. The Plant is owned and operated by Nevada Energy (NE). In 1983, DWR entered into a Participation Agreement to import power from the Plant to serve the State Water Project energy needs. DWR's interest in the Plant terminated on July 25, 2013. DWR and NE negotiated the terms of the divestiture including DWR's obligations to mitigate any environmental impacts associated with the electricity generated for DWR over the past thirty years. Metropolitan paid approximately 75.0 percent of DWR's costs associated with the generation of electricity at the Plant and will pay this proportion of DWR's assigned mitigation costs.

### (j) Landfill Obligation

Federal and State laws and regulations require that Metropolitan perform certain maintenance and monitoring functions at its sole landfill site for 30 years after closure. They further require that a separate funding mechanism be established to ensure that sufficient funds are available for closure and postclosure costs. In October 1995, the landfill was closed and management's estimate of closure and postclosure costs for this site totaled approximately $2.0 million. The required thirty-year postclosure maintenance and monitoring of the landfill officially started in January 1998; after the installation of the landfill's final cover was completed. Approximately $18,100 was expended for post closure maintenance and monitoring activities during the three months ended September 30, 2020 while no amounts were expended during the three months ended September 30, 2019.

The actual cost of postclosure care may be higher due to inflation, changes in technology, or changes in landfill laws or regulations. Funding of these costs has been derived from a separate trust account that has been established for closure and postclosure costs. The balance of the trust account is sufficient to cover the landfill liability.

## 7. PARTICIPATION RIGHTS IN STATE WATER PROJECT

Metropolitan is one of 29 water suppliers contracting with the State of California for a system to provide water throughout much of California. Under the terms of the State Water Contract, as amended, Metropolitan is obligated to pay allocable portions of the cost of construction of the system and ongoing operations and maintenance costs through at least the year 2035, regardless of the quantities of water available from the project (see Note 6a). Metropolitan and the other contractors may also be responsible to the State for certain obligations of any contractor who defaults on its payments to the State.

Approximately 33 percent and 35 percent of Metropolitan's total expenditures during the three months ended September 30, 2020 and 2019, respectively, pertained to its net payment obligations for the State Water Project. These payments were primarily based on the contractual water delivery request, the annually requested and actual deliveries received, and the cost of power required for such deliveries, offset by credits received from the project.

The State Water Contract provides Metropolitan rights to water through 2052 but Management's present intention is to exercise Metropolitan's option to extend the contractual period to at least 2085, under similar terms, based on the Agreement in Principle reached in 2014. This corresponds to an estimated 125-year service life for the original facilities. The State is obligated to provide specified quantities of water throughout the life of the contract, subject to certain conditions.

The State has power generation facilities associated with its reservoirs and aqueducts. The power generated is utilized by the system for water transportation purposes. Power generated in excess of system needs is marketed to various utilities and California's power market. The revenues resulting from sales of excess power reduce the costs of pumping. Metropolitan and the other water contractors are responsible for repaying the capital and operating costs of the power facilities regardless of the amount of power generated.

Metropolitan capitalizes its share of system construction costs as participation rights when such costs are billed by the State (see Notes 1i and 6a). Metropolitan's share of system operations and maintenance costs is charged to expense.

Metropolitan amortizes a portion of capitalized participation rights each month using a formula that considers the total estimated cost of the project, the estimated useful life, and estimated production capacity of the assets based upon maximum annual contracted deliveries provided by the State of California. Amortization expense totaled $35.7 million and $35.4 million for the three months ended September 30, 2020 and 2019, respectively.

## 8. DEPOSITS, PREPAID COSTS, AND OTHER

Balances at September 30, 2020 and 2019 were as follows:

| | September 30, | |
|---|---|---|
| (Dollars in thousands) | **2020** | 2019 |
| Prepaid water costs | **$ 241,197** | $ 224,610 |
| Prepaid costs-Delta Habitat Conservation and Conveyance | **58,627** | 58,627 |
| Prepaid costs-California WaterFix | **7,494** | 41,500 |
| Prepaid expenses | **28,114** | 20,817 |
| Preliminary design/reimbursable projects | **17,572** | 13,571 |
| Other | **143,400** | 140,352 |
| Total deposits, prepaid costs, and other | **496,404** | 499,477 |
| Less current portion | **(127,135)** | (129,093) |
| Noncurrent portion | **$ 369,269** | $ 370,384 |

### (a) Prepaid Water Costs

Metropolitan has entered into several water exchange and storage agreements with other agencies. These agreements provide Metropolitan with additional reliable water supplies to supplement deliveries of Colorado River and SWP water. Metropolitan is also actively pursuing other agreements, both within and outside its service area, to provide additional water supplies. The exchange and storage agreements generally provide for advance delivery of water during periods when water is available. At a later time when water is needed, these programs can then return water to improve Metropolitan's reliability. Expenditures associated with these agreements have been recorded as prepaid costs and are charged to cost of water as the water is withdrawn. At September 30, 2020 and 2019, prepaid water costs totaled approximately $241.2 million and $224.6 million, respectively, based on volumes of 1,098 TAF and 1,128 TAF, as of such dates.

### (b) Prepaid Costs—Delta Habitat Conservation and Conveyance

In March 2009, Metropolitan, other SWP contractors, federal Central Valley Project contractors, and the U.S. Department of Interior's Bureau of Reclamation entered into funding agreements with DWR. The agreements are known collectively as the Delta Habitat Conservation and Conveyance Program (DHCCP) Funding Agreement and the Bay Delta Conservation Plan and Delta Habitat Conservation and Conveyance Plan (BDCP - DHCCP) Supplemental Funding Agreement. Metropolitan's three-year DHCCP agreement provides funding of approximately $35.0 million for Metropolitan's share (24 percent). Metropolitan's two-year BDCP-DHCCP agreement provides funding of approximately $25.0 million (25 percent). The funding provided by both agreements supports development of the BDCP which was later on adapted as California WaterFix (see Note 6b) through environmental analysis, planning and design of Delta conservation measures including Delta water conveyance options. The two-tunnel California WaterFix project shifted to a single tunnel project referred to as the Delta Conveyance Project with the announcement of Governor Newsom on February 12, 2019. Total prepaid costs at September 30, 2020 and 2019 were $58.6 million.

### (c) Prepaid Costs—California WaterFix

In fiscal year 2019, Metropolitan disbursed a total of $41.5 million to DWR for preconstruction planning costs of the CWF in accordance with the advance funding agreement entered into in August 2018. The $41.5 million was Metropolitan's share (31 percent) of the funding and DWR intends to refund Metropolitan for funds advanced through this agreement through bond financing actions. However, as a result of the shift to a single tunnel project and DWR's withdrawal of approval of the CWF Project as well as the rescission of other permitting applications (see Note 8b), Metropolitan has requested, on June 27, 2019, that DWR return its contributions that have not been spent as of May 2, 2019. In fiscal year 2020, DWR remitted $34.0 million of unspent funds and $.5 million of interest. Total prepaid costs at September 30, 2020 and 2019 were $7.5 million and $41.5 million, respectively.

### (d) Preliminary Design/Reimbursable Projects

Metropolitan engages in preliminary design activities prior to obtaining Board approval of capital projects. The costs of these designs are recorded as prepaid costs. Once Board approval is obtained, these costs are added to the cost of the relevant construction project.

Reimbursable projects include work Metropolitan is contracted to perform for outside, non-related parties, and is subsequently billed for reimbursement.

## 9. DEFERRED COMPENSATION AND SAVINGS PLANS

For the benefit of its employees, Metropolitan has adopted a deferred compensation plan in accordance with Section 457 of the Internal Revenue Code. Generally, eligible employees may defer receipt of a portion of their salary until termination, retirement, death, or unforeseeable emergency. Until the funds are paid or otherwise made available to the employee, the employee is not obligated to report the deferred salary for income tax purposes.

Metropolitan has established another compensation deferral arrangement in accordance with Section 401(k) of the Internal Revenue Code. The 401(k) Consolidated Savings Plan (savings plan) is available to substantially all employees. Metropolitan has established a matching contribution program, subject to a maximum of 4.5 percent of the employee's total cash compensation, on behalf of each participating employee in the savings plan. Amounts deferred by participants, Metropolitan matching contributions, and accumulated earnings thereon are fully vested.

Deferred amounts and matching contributions, if any, for both plans are transferred by Metropolitan each pay period to a third-party administrator who coordinates the investment of such proceeds in a variety of investment vehicles in accordance with the instructions of each participant. Accordingly, neither the assets nor the related liability of each plans were included in the accompanying basic financial statements at September 30, 2020 and 2019.

The Treasurer serves as Trustee for both the deferred compensation and savings plans. Metropolitan is not liable to its employees for any losses that may be incurred in connection with their participation in the plans.

## 10. NET POSITION

Net position is classified as either restricted, unrestricted, or net investment in capital assets, including State Water Project Costs.

Net investment in capital assets, including State Water Project costs consist of capital assets, net of accumulated depreciation and amortization, and reduced by the outstanding balances of any bonds, notes, or other borrowings attributable to the acquisition or construction of those assets and deferred outflows and inflows of resources related to debt. Metropolitan's capital assets, including State Water Project costs include plant and equipment (Note 1h), participation rights in State Water Project (Notes 1i and 7), and participation rights in other facilities. Net investment in capital assets, including State Water Project costs were approximately $6.3 billion at September 30, 2020 and 2019.

The restricted component of net position are those items that have external constraints placed on them by creditors, grantors, contributors, or laws or regulations of other governments, or imposed by law through constitutional provisions of enabling legislation. Restricted net position totaled $511.3 million and $457.3 million at September 30, 2020 and 2019, respectively, of which $234.5 million and $218.6 million, respectively, represents principal and interest set aside for the next bond payment. The remaining $276.8 million and $238.7 million, respectively, relates to estimated operating and maintenance expense for October and November 2020. Each of these requirements are related to bond covenants.

The unrestricted component of net position are those items that do not meet the definition of "restricted" or "net investment in capital assets, including State Water Project costs." Unlike the restricted net position, the Board has discretion in determining the use and establishing minimum/maximum balance requirements for the unrestricted cash and investment portion of net position. The Board may at any time change or eliminate amounts established for these purposes. Unrestricted net position totaled $161.8 million and $138.9 million at September 30, 2020 and 2019, respectively.

## 11. RISK MANAGEMENT

Metropolitan is exposed to various risks of loss related to the design, construction, treatment, and delivery of water resources. Metropolitan self-insures most of its property losses, the first $25.0 million for general liability, fiduciary liability and directors' and officers' liability, and $5.0 million for workers' compensation. Metropolitan supplements its self-insurance program with $75.0 million excess general liability coverage, $60.0 million excess fiduciary liability coverage, $65.0 million excess for directors' and officers' liability coverage, and statutory limits excess workers' compensation coverage. Special insurance policies carried include aircraft hull and liability, a limited property damage policy, crime insurance, specialty crime coverage, and travel accident coverage. Coverage types and limits for fiscal year 2021 were unchanged from fiscal year 2020. Settlement amounts did not exceed the self-insurance or insurance coverage limits in any of the past three years.

Liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. Liabilities include an estimated amount for claims that have been incurred but not reported. Claims liabilities are calculated considering the effects of inflation, recent claim settlement trends including frequency and amount of payouts, and other economic and social factors. The present value of liabilities for unpaid claims is based on a 1.5 percent annual interest rate over the life of the claims.

## 12. COVID-19 PANDEMIC

Metropolitan is assessing the effects that the ongoing COVID-19 outbreak, and measures taken by State and local governments to slow the virus' spread, will have on Metropolitan and its business and operations, as well as in the region that comprises Metropolitan's service area. While federal and state governments, including California, have enacted legislation and have taken executive actions designed to mitigate the negative public health and economic impacts of the COVID-19 pandemic, Metropolitan is unable to predict whether such interventions will have the intended effects. Reduced economic activity and its associated impacts, including as a result of the COVID-19 outbreak itself, such as job losses, income losses, business closures and housing foreclosures or vacancies, and any prolonged recession that may occur, could have a variety of adverse effects on Metropolitan and in the region. Declines in assessed valuations in Metropolitan's service area and/or increases in property tax delinquencies or non-payment of taxes as a result of the economic disruption may negatively affect property tax collections and reduce tax levy receipts.

Economic conditions affect aggregate levels of retail water use and may reduce water demands in the region and Metropolitan's water transactions and revenues. A protracted disruption in the manufacturing or construction industry may affect supply chains or delay construction schedules for, or the implementation of, Metropolitan's capital improvement programs and projects, and may increase the costs of such projects or program or

Metropolitan's water system operations. Sustained deterioration in global stock market values may impact the market value of assets held to fund Metropolitan's pension and other post-employment benefit plans, which could result in future increases in required plan contributions. The extent and period of disruption to or decline in the local and global economies, the duration and severity of the outbreak, and the ramifications of future actions that may be taken or required by governmental authorities to contain and respond to the outbreak are uncertain, and no assurances can be given that Metropolitan's operations and finances will not be negatively affected.