THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

Basic Financial Statements

Six Months ended December 31, 2017 and 2016

(Unaudited)

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UNAUDITED
December 31, 2017 and 2016

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 six months ended December 31, 2017 and 2016. 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 operates as a utility enterprise and maintains its accounting records in accordance with generally accepted accounting principles for proprietary funds 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 years 2017 and 2016 have been reclassified to conform to the fiscal year 2018 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)	December 31, 2017	2016	2015
Assets and deferred outflows of resources			
Capital assets, net	**$ 10,561.5**	$ 10,547.9	$ 10,386.4
Other assets	**1,838.9**	2,033.7	2,109.9
Deferred outflows of resources	**204.6**	154.3	171.0
Total assets and deferred outflows of resources	**12,605.0**	12,735.9	12,667.3
Liabilities and deferred inflows of resources			
Long-term liabilities, net of current portion	**4,775.9**	4,978.3	4,937.7
Other liabilities	**864.7**	867.4	732.1
Deferred inflows of resources	**23.2**	40.1	109.2
Total liabilities and deferred inflows of resources	**5,663.8**	5,885.8	5,779.0
Net position			
Net investment in capital assets, including State Water Project costs	**6,067.9**	5,986.2	5,799.9
Restricted	**402.1**	331.1	378.4
Unrestricted	**471.2**	532.8	710.0
Total net position	**$ 6,941.2**	$ 6,850.1	$ 6,888.3

Capital Assets, Net

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

Second Quarter Fiscal 2018 Compared to Second Quarter Fiscal 2017. At December 31, 2017, net capital assets totaled $10.6 billion, or 83.8 percent, of total assets and deferred outflows of resources, and were $13.6 million higher than the prior year. The increase included Metropolitan's continued expenditures on the capital investment plan of $262.9 million (including $7.1 million of capitalized interest) and net capital payments for participation rights in the State Water Project and other facilities of $135.7 million. These increases were offset by depreciation and amortization of $271.0 million and $114.0 million retirement of capital assets and write-off of Mills Mods 1 and 2. See the capital assets and debt administration section for additional information.

Second Quarter Fiscal 2017 Compared to Second Quarter Fiscal 2016. At December 31, 2016, net capital assets totaled $10.5 billion, or 82.8 percent, of total assets and deferred outflows of resources, and were $161.5 million higher than the prior year. The increase was primarily due to a $175.9 million Board approved land purchase in the Delta Wetlands in July 2016. Additional increases included Metropolitan's continued expenditures on the capital investment plan of $239.8 million (including $7.9 million of capitalized interest) and net capital payments for participation rights in the State Water Project and other facilities of $132.3 million. These increases were offset by depreciation and amortization of $386.5 million. See the capital assets and debt administration section for additional information.

Other Assets

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

Second Quarter Fiscal 2018 Compared to Second Quarter Fiscal 2017. At December 31, 2017, other assets totaled $1.8 billion and were $194.8 million less than the prior year. Cash and investments were $306.8 million lower primarily due to the $250.0 million prepayment of short-term revolving notes. The decrease in cash and investments was partially offset by $40.8 million higher inventory primarily due to an increase in water storage of 188.3 thousand acre-feet (TAF) and $40.4 million higher deposits, prepaid costs, and other primarily due to $41.9 million or 406.4 TAF more of prepaid water costs. In addition, water sales receivable were $25.6 million higher as fiscal year 2018 November and December sales were 11.0 TAF more than the prior year's comparable months.

Second Quarter Fiscal 2017 Compared to Second Quarter Fiscal 2016. At December 31, 2016, other assets totaled $2.0 billion and were $76.2 million lower than the prior year. Included in the decrease were $39.6 million of lower water inventory primarily due to the fact that the $44.4 million water purchase from Southern Nevada Water Authority (noted below) did not occur in the current year. In addition, deposits, prepaid costs, and other were $38.0 million lower due to $30.0 million of lower prepaid water costs or 221.7 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 deferred outflows for effective interest rate swaps.

Second Quarter Fiscal 2018 Compared to Second Quarter Fiscal 2017. At December 31, 2017, deferred outflows of resources totaled $204.6 million and were $50.3 million more than the prior year. The increase was primarily due to $82.0 million net difference in projected and actual earnings related to the net pension liability. This increase was offset by $8.0 million lower deferred outflows on effective swaps due to rising interest rates and $18.8 million lower deferred outflows related to loss on bond refundings due to $12.8 million of refunding transactions and $6.0 million of scheduled amortization.

Second Quarter Fiscal 2017 Compared to Second Quarter Fiscal 2016. At December 31, 2016, deferred outflows of resources totaled $154.3 million and were $16.7 million less than the prior year. Included in the decrease was $15.6 million less deferred outflows related to loss on bond refundings due to $8.2 million of refunding transactions and $7.4 million of scheduled amortization in addition to $12.0 million lower deferred outflows on effective swaps due to higher interest rates. The decreases were offset by $14.2 higher deferred outflows related to the net pension liability due to a $10.1 million difference between expected versus actual experience.

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, postemployment benefits other than pensions (OPEB), accrued compensated absences, obligations for off-aqueduct facilities, workers' compensation and third party claims, fair value of interest rate swaps, and other long-term obligations.

Second Quarter Fiscal 2018 Compared to Second Quarter Fiscal 2017.
At December 31, 2017, long-term liabilities, net of current portion, totaled $4.8 billion and were $202.4 million lower than the prior year. Long-term debt, net of current portion were $449.2 million lower due to $163.0 million of scheduled principal payments, $242.0 million decrease related to bond refundings as the new debt issued was less than the amount refunded, and $180.0 million of long-term debt became current as a result of self-liquidity bonds that are not supported by the Revolving Credit Agreement that will expire on June 24, 2018 (see other liabilities section below). The decreases in long-term debt were offset by $160.0 million of new bonds issued. Additional decrease included $46.6 million lower customer deposits and trust funds, net of current portion primarily due to $50.4 million termination of the San Luis Rey trust. Offsetting these decreases were $198.3 million of revolving notes sold to refund several issues of water revenue refunding bonds and $108.1 million due to the decrease of actual pension plan investment earnings as compared to the prior year. See the long-term debt section for additional information.

Second Quarter Fiscal 2017 Compared to Second Quarter Fiscal 2016. At December 31, 2016, long-term liabilities, net of current portion, totaled $5.0 billion and were $40.6 million higher than the prior year. The increase included $72.8 million more of net pension liability due to the decrease of actual pension plan investment earnings as compared to the prior year. This increase was offset by $22.5 million reduction in long-term debt, net of current portion. This decrease included scheduled principal payments of $146.1 million and a $49.2 million principal reduction related to bond refundings, as the new debt issued was less than the amount of debt refunded offset by $175.0 million of new debt issued. The fair value of interest rate swaps liability account represents a negative market value which improved by $12.0 million due to rising interest rates. See the long-term debt section for additional information.

Other Liabilities

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

Second Quarter Fiscal 2018 Compared to Second Quarter Fiscal 2017.

At December 31, 2017, other liabilities totaled $864.7 million and were $2.7 million lower than prior year. The decrease was due to a $250.0 million prepayment of revolving notes in November 2017. This decrease was offset by $180.0 million higher current portion of long-term debt as the 2015 Series A-1 and A-2, Special Variable Rate Water Revenue Refunding Bonds will not be covered by the Revolving Credit Agreement that is expiring on June 24, 2018. In addition, accounts payable and accrued expenses were $69.4 million higher primarily due to $60.8 million of higher State Water Project costs.

Second Quarter Fiscal 2017 Compared to Second Quarter Fiscal 2016. At December 31, 2016, other liabilities totaled $867.4 million, and were $135.3 million higher than the prior year primarily due to $250.0 million of revolving notes issued by Metropolitan in fiscal year 2016. Offsetting this increase was $100.1 million lower accounts payable and accrued expenses, which included $73.4 million of lower State Water Project costs primarily due to $55.0 million of Flex Storage pay down and $13.2 million less of conservation credit expenses as the $450.0 million budget in fiscal year 2015 is spent down (see Operating Expenses).

Deferred Inflows of Resources

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

Second Quarter Fiscal 2018 Compared to Second Quarter Fiscal 2017. At December 31, 2017, deferred inflows of resources totaled $23.2 million, and were $16.9 million lower than the prior year primarily due to $18.2 million lower deferred inflows related to the net pension liability. This decrease included $16.1 related to net difference between projected and actual earnings and $10.9 million due to change in assumptions offset by $8.8 million higher difference between actual and expected experience.

Second Quarter Fiscal 2017 Compared to Second Quarter Fiscal 2016. At December 31, 2016, deferred inflows of resources totaled $40.1 million, and were $69.1 million lower than the prior year due to $93.2 million lower actual pension plan investment earnings as compared to prior year partially offset by $24.1 million of deferred pension expenses due to change in assumptions.

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 State Water Project, offset by debt issued for these purposes.

Second Quarter Fiscal 2018 Compared to Second Quarter Fiscal 2017. At December 31, 2017, net investment in capital assets, including State Water Project costs totaled $6.1 billion and was $81.7 million higher than the prior year. This increase included $65.7 million decrease in net outstanding debt and $13.6 million net increase in capital assets. See discussions of these items in the capital assets and long-term debt sections.

Second Quarter Fiscal 2017 Compared to Second Quarter Fiscal 2016. At December 31, 2016, net investment in capital assets, including State Water Project costs totaled $6.0 billion and was $186.3 million more than the prior year. This increase included $161.5 million net increase in capital assets and $30.0 million net decrease in outstanding debt. See discussions of these items in the capital assets and long-term debt sections.

Restricted Net Position

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

Second Quarter Fiscal 2018 Compared to Second Quarter Fiscal 2017. At December 31, 2017, restricted net position totaled $402.1 million which was $71.0 million higher than fiscal year 2016. The increase was primarily due to $71.1 million of higher restricted for debt service resulting from higher principal and interest payments.

Second Quarter Fiscal 2017 Compared to Second Quarter Fiscal 2016. At December 31, 2016, restricted net position totaled $331.1 million which was $47.3 million lower than fiscal year 2016. The decrease included $78.4 million of lower restricted for debt service offset by $31.1 million higher restricted for operating expenses.

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.

Second Quarter Fiscal 2018 Compared to Second Quarter Fiscal 2017. Unrestricted net position of $471.2 million decreased $61.6 million from the prior year, which was the result of $71.0 million of higher restricted net position requirements for debt service and operating expenses and $81.7 million increase in net investment in capital assets, partially offset by the twelve months ended December 31, 2017 net income before contributions of $90.1 million.

Second Quarter Fiscal 2017 Compared to Second Quarter Fiscal 2016. Unrestricted net position of $532.8 million decreased $177.2 million from the prior year which, included $186.3 million increase in net investment in capital assets and the twelve months ended December 31, 2016 net loss before contributions of $40.5 million partially offset by $47.4 million of lower restricted net position requirements for debt service and operating expenses.

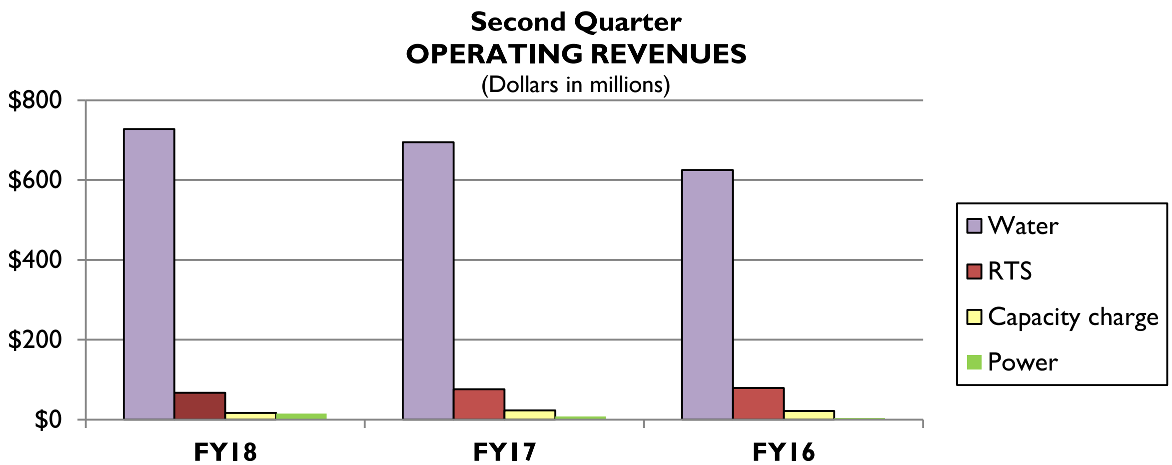
CHANGES IN NET POSITION

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

	Six Months Ended December 31,		
(Dollars in millions)	**2017**	2016	2015
Water sales	**$ 727.6**	$ 694.7	$ 624.7
Readiness-to-serve charges	**67.5**	76.5	79.0
Capacity charge	**16.8**	22.9	21.8
Power sales	**15.1**	8.4	3.8
Operating revenues	**827.0**	802.5	729.3
Taxes, net	**60.7**	56.3	52.3
Investment income (loss)	**5.7**	(3.3)	3.4
Other	**9.0**	2.4	6.8
Nonoperating revenues	**75.4**	55.4	62.5
Total revenues	**902.4**	857.9	791.8
Power and water costs	**(265.4)**	(224.8)	(274.0)
Operations and maintenance	**(237.8)**	(251.7)	(311.9)
Depreciation and amortization	**(151.0)**	(147.3)	(134.0)
Operating expenses	**(654.2)**	(623.8)	(719.9)
Bond interest, net of amount capitalized	**(63.3)**	(65.7)	(62.1)
Other	**(2.6)**	(2.2)	(3.1)
Nonoperating expenses	**(65.9)**	(67.9)	(65.2)
Total expenses	**(720.1)**	(691.7)	(785.3)
Income (loss) before contributions	**182.3**	166.2	6.7
Capital contributions	**1.2**	0.1	—
Changes in net position	**183.5**	166.3	6.7
Net position, at June 30,	**6,757.7**	6,683.8	6,881.6
Net position, at December 31,	**$ 6,941.2**	$ 6,850.1	$ 6,888.3

Operating Revenues

Metropolitan's principal source of revenue is from water sales, 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.



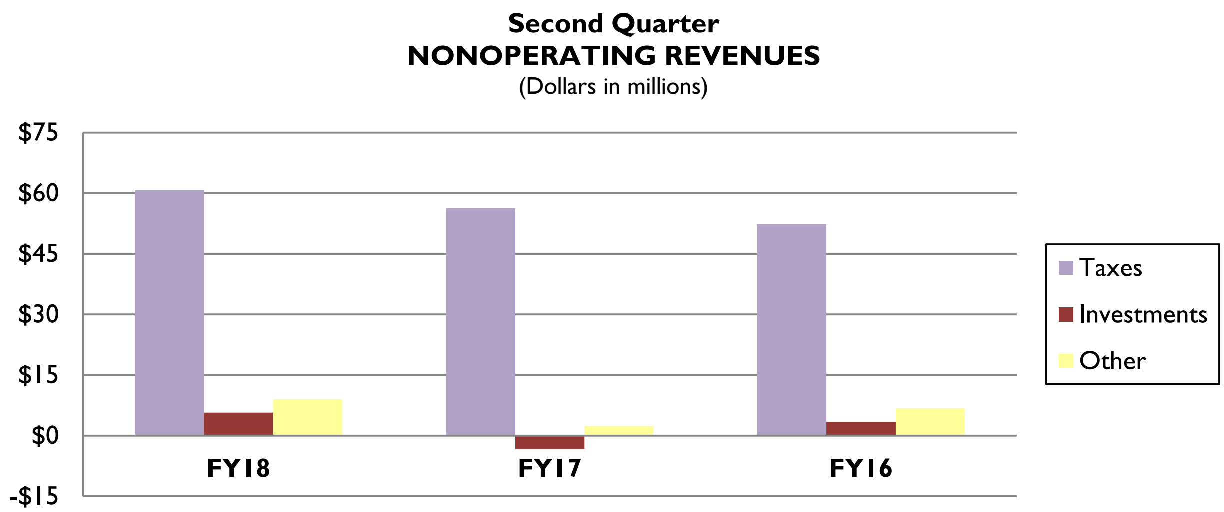
Analytical Review of Operating Revenues

Second Quarter Fiscal 2018 Compared to Second Quarter Fiscal 2017. For the six months ended December 31, 2017 operating revenues were $827.0 million or $24.5 million more than the prior year primarily due to $33.0 million of higher water sales, of which $81.6 million related to higher rates offset by $48.6 million or 67.0 thousand acre-feet (TAF) of lower volumes sold. The increase was partially offset by $9.0 million lower readiness-to-serve charge due to lower Board approved rate.

Second Quarter Fiscal 2017 Compared to Second Quarter Fiscal 2016. For the six months ended December 31, 2016 operating revenues were $802.5 million or $73.2 million more than the prior year primarily due to $70.0 million of higher water sales, of which $61.5 million related to 85.7 TAF of higher volumes sold and $8.5 million from higher rates.

Nonoperating Revenues

The primary source of nonoperating revenues is property taxes.



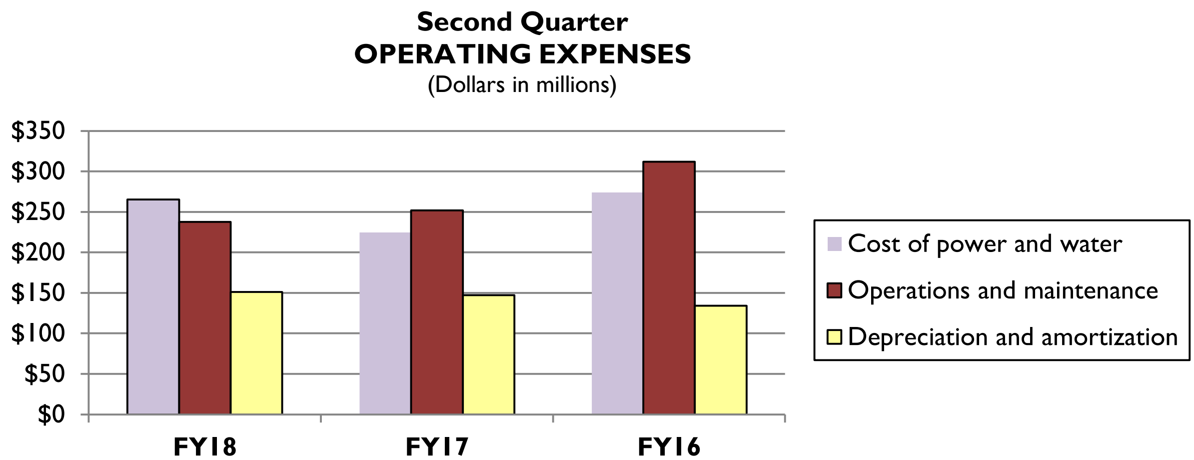
Analytical Review of Nonoperating Revenues

Second Quarter Fiscal 2018 Compared to Second Quarter Fiscal 2017. Nonoperating revenues for the six months ended December 31, 2017 totaled $75.4 million and were $20.0 million higher than the prior year. The increase included $9.0 million more of investment income of which $6.5 million related to favorable change in fair value of investments and $2.4 million higher rate of return. In addition, taxes, net increased $4.4 million due to higher assessed values.

Second Quarter Fiscal 2017 Compared to Second Quarter Fiscal 2016. Nonoperating revenues for the six months ended December 31, 2016 totaled $55.4 million and were $7.1 million lower than the prior year primarily due to $7.5 million of unfavorable change in fair value of investments.

Operating Expenses

Operating expenses fall into three primary cost areas: power and water, operations and maintenance, and depreciation and amortization.



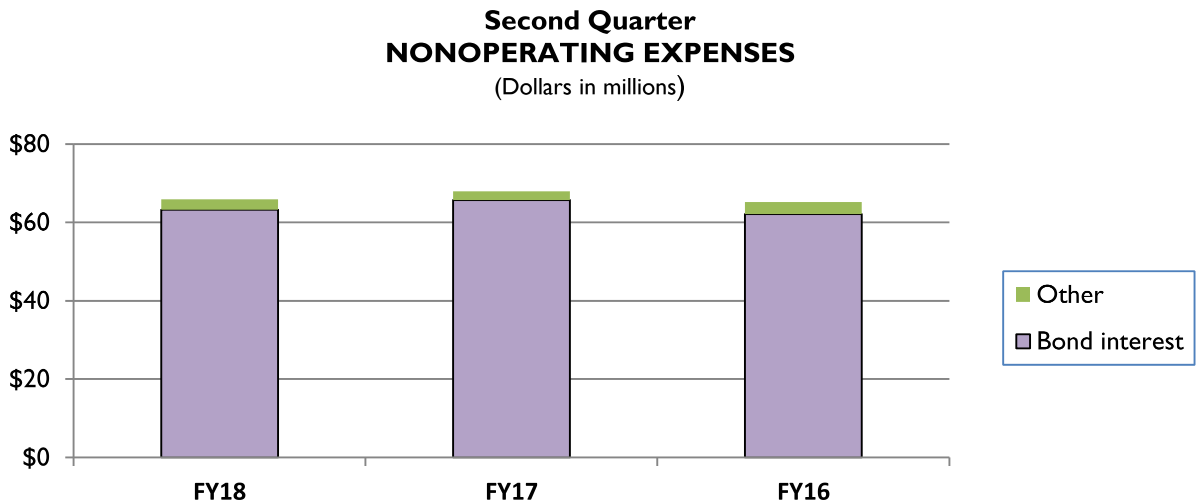
Analytical Review of Operating Expenses

Second Quarter Fiscal 2018 Compared to Second Quarter Fiscal 2017. For the six months ended December 31, 2017 operating expenses of $654.2 million were $30.4 million higher than prior year primarily due to $40.7 million of higher power and water costs as the $46.3 million credit in fiscal year 2017 was not present in fiscal year 2018. This increase was partially offset by $13.8 million of lower operations and maintenance costs primarily due to $21.9 million lower conservation credits expenses as the $450.0 million budget in fiscal year 2015 continued to be spent down offset by an increase in labor cost of $8.7 million resulting from the recently concluded labor negotiations.

Second Quarter Fiscal 2017 Compared to Second Quarter Fiscal 2016. For the six months ended December 31, 2016 operating expenses of $623.8 million were $96.1 million lower than prior year. The decrease included $60.2 million of lower operations and maintenance costs primarily due to $62.3 million lower conservation credits expenses as the $450.0 million budget in fiscal year 2015 for conservation spending is spent down. In addition, power and water costs decreased $49.2 million primarily due to $37.0 million higher credit related to the State Water Project in fiscal year 2017.

Nonoperating Expenses

The primary source of nonoperating expenses is interest expense on bonds and other, net.



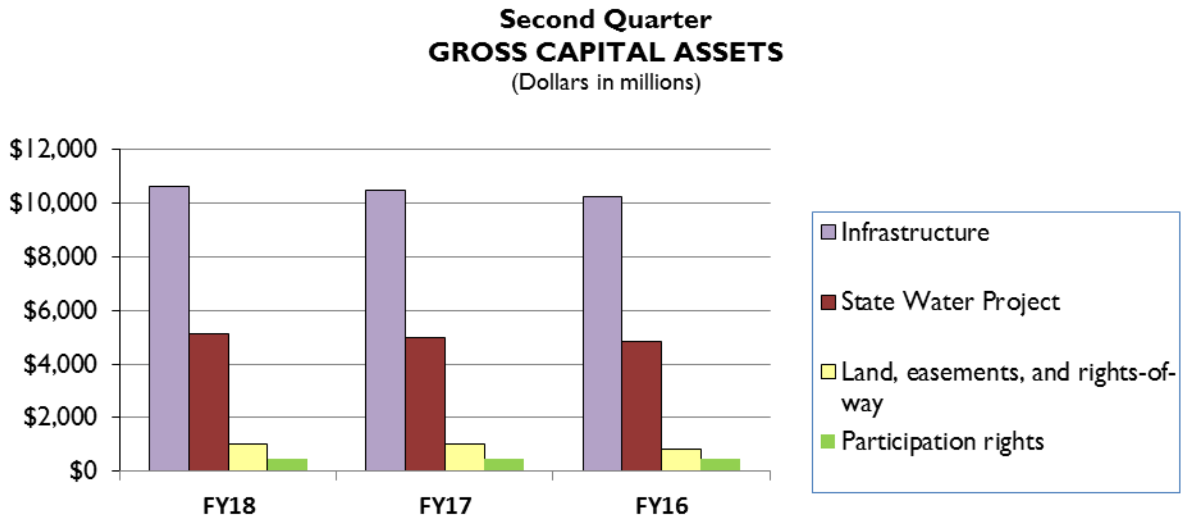
Analytical Review of Nonoperating Expenses

Second Quarter Fiscal 2018 Compared to Second Quarter Fiscal 2017. For the six months ended December 31, 2017 nonoperating expenses of $65.9 million were $2.0 million lower than the prior year primarily due to a decrease of $2.4 million in bond interest expense related to bond refunding transactions to take advantage of lower interest rates.

Second Quarter Fiscal 2017 Compared to Second Quarter Fiscal 2016. For the six months ended December 31, 2016 nonoperating expenses of $67.9 million were $2.7 million higher than the prior year primarily due to a decrease in capitalized interest on assets constructed.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital assets include Metropolitan's water infrastructure, land and buildings, as well as participation rights in State Water Project and various other water programs.



Schedule of Capital Assets

(Dollars in millions)	December 31, 2017	2016	2015
Land, easements and rights-of-way	**$ 1,010.9**	$ 1,008.5	$ 814.2
Construction in progress	**1,114.3**	911.1	1,759.7
Parker power plant and dam	**13.0**	13.0	13.0
Power recovery plants	**196.9**	180.3	178.7
Other dams and reservoirs	**1,549.8**	1,546.3	1,541.7
Water transportation facilities	**3,744.1**	3,708.9	3,504.0
Pumping plants and facilities	**294.3**	293.6	240.7
Treatment plants and facilities	**2,796.5**	2,924.1	2,138.6
Buildings	**138.9**	136.1	136.1
Other plant assets	**713.8**	701.7	681.2
Pre-operating expenses original aqueduct	**44.6**	44.6	44.6
Participation rights in State Water Project	**5,114.6**	4,978.9	4,844.4
Participation rights in other facilities	**459.7**	459.7	461.9
Gross capital assets	**17,191.4**	16,906.8	16,358.8
Less accumulated depreciation and amortization	**(6,629.9)**	(6,358.9)	(5,972.4)
Capital assets, net	**$ 10,561.5**	$ 10,547.9	$ 10,386.4
Net increase from prior year	**$ 13.6**	$ 161.5	$ 219.6
Percent change	**0.1%**	1.6%	2.2%

Second Quarter Fiscal 2018 Compared to Second Quarter Fiscal 2017. Net capital assets totaled approximately $10.6 billion and increased $13.6 million over the prior year. This increase included $262.9 million of new construction activity, and a net increase of $135.7 million in participation rights in State Water Project and other facilities. These increases were offset by depreciation and amortization of $271.0 million and $114.0 million retirement of capital assets and write-off of Mills Mods 1 and 2.

The major capital asset additions for the current year, excluding capitalized interest, included:

- $42.8 million for the distribution system's rehabilitation program.
- $41.4 million for relining the regional water system's second lower feeder pipeline.
- $37.6 million for the improvements in infrastructure reliability at the treatment plants.
- $27.5 million for the Colorado River Aqueduct (CRA) reliability and containment programs. These programs were established to provide infrastructure reliability and regulatory compliance throughout the CRA conveyance system.
- $21.8 million for the oxidation retrofit program at the filtration plants; this program is designed to reduce the level of disinfection byproducts in the treated water supplied by these plants in order to meet state and federal standards.

Metropolitan's fiscal year 2018 capital budget includes plans to spend $240.0 million principally for the water treatment plants improvements program, the distribution system and rehabilitation projects, the Colorado River Aqueduct reliability and containment programs, the water quality/oxidation retrofit program, and the supply reliability and system expansion program.

Second Quarter Fiscal 2017 Compared to Second Quarter Fiscal 2016. Net capital assets totaled approximately $10.5 billion and increased $161.5 million over the prior year. This increase included $175.9 million Delta Wetlands land purchase, $239.8 million of new construction activity, and a net increase of $132.3 million in participation rights in State Water Project and other facilities. These increases were offset by depreciation and amortization of $386.5 million.

The major capital asset additions for the current year, excluding capitalized interest, included:

- $73.5 million for the improvements in infrastructure reliability at the treatment plants.
- $42.4 million for the distribution system's rehabilitation program.
- $30.6 million for the 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 State Water Project delivery constraints.
- $18.4 million for the oxidation retrofit program at the filtration plants; this program is designed to reduce the level of disinfection byproducts in the treated water supplied by these plants in order to meet state and federal standards.
- $18.1 million for the pre-stressed concrete cylinder pipe reliability (PCCP) program; this program identifies pipelines whose age, location and condition warrant refurbishment/replacement to insure long-term reliability of Metropolitan's PCCP lines water delivery.
- $10.8 million for chlorine containment and handling facilities program, which is designed to enhance hazardous chemical safety, prevent a chlorine chemical release, and comply with security and safety regulations.

LONG-TERM DEBT

Schedule of Long-term Debt, Including Current Portion

	December 31,		
(Dollars in millions)	**2017**	2016	2015
General obligation bonds *(a)*	**$ 74.9**	$ 92.9	$ 110.4
Revenue bonds *(a)*	**4,008.1**	4,235.2	4,238.0
State revolving loan	**—**	8.6	10.2
Other, net *(b)*	**204.6**	214.9	223.0
	$ 4,287.6	$ 4,551.6	$ 4,581.6
Increase (decrease) from prior year	**$ (264.0)**	$ (30.0)	$ 58.3
Percent change	**(5.8%)**	(0.7%)	1.3%

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

Second Quarter Fiscal 2018 Compared to Second Quarter Fiscal 2017. At December 31, 2017, there was $4.3 billion of outstanding bonds and other long-term obligations, a net decrease of $264.0 million or 5.8 percent from the prior year. The lower balance was due to $242.0 million decrease related to bond refundings as the new debt issued was less than the amount refunded, $163.0 million of scheduled principal payments, $10.4 million of amortization of bond premiums and discounts, and $8.6 million reduction related to the refunding of the State Revolving Fund loan. These decreases were partially offset by $160.0 million in new revenue bonds issued.

Second Quarter Fiscal 2017 Compared to Second Quarter Fiscal 2016. At December 31, 2016, there was $4.6 billion of outstanding bonds and other long-term obligations, a net decrease of $30.0 million or 0.7 percent from the prior year. The decrease included scheduled principal payments of $146.1 million and a $49.2 million principal reduction related to bond refundings, as the new debt issued was less than the amount of debt refunded. In addition, scheduled amortization of bond premiums and discounts was $8.2 million lower. These decreases were offset by $175.0 million of new debt issued.

CREDIT RATINGS

Metropolitan's credit ratings at December 31, 2017, 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+

STATEMENTS OF NET POSITION

(Dollars in thousands)	December 31, 2017	2016
ASSETS AND DEFERRED OUTFLOWS OF RESOURCES	(Unaudited)	
Current Assets:		
Cash and investments, at fair value (Notes 1b and 2):		
Unrestricted (cost: $263,821 and $701,269 for 2017 and 2016, respectively)	**$ 263,376**	$ 700,857
Restricted (cost: $379,246 and $341,739 for 2017 and 2016, respectively)	**378,608**	341,538
Total cash and investments	**641,984**	1,042,395
Receivables:		
Water sales	**238,057**	212,412
Interest on investments	**4,973**	4,053
Other, net (Note 1e)	**109,011**	104,523
Total receivables	**352,041**	320,988
Inventories (Note 1f)	**117,364**	76,612
Deposits, prepaid costs, and other (Note 8)	**66,143**	70,034
Total current assets	**1,177,532**	1,510,029
Noncurrent Assets:		
Cash and investments, at fair value (Notes 1b and 2):		
Unrestricted (cost: $340,296 and $183,203 for 2017 and 2016, respectively)	**339,722**	183,096
Restricted (cost: $76,985 and $138,865 for 2017 and 2016, respectively)	**79,836**	142,884
Total cash and investments	**419,558**	325,980
Capital assets:		
Plant and equipment - non depreciable (Notes 1g and 6g)	**2,089,025**	1,919,562
Plant and equipment - depreciable (Notes 1g and 6g)	**9,528,012**	9,548,664
Participation rights in State Water Project (Notes 1h and 7)	**5,114,629**	4,978,908
Participation rights in other facilities (Note 1h)	**459,709**	459,709
Total capital assets	**17,191,375**	16,906,843
Less accumulated depreciation and amortization	**(6,629,919)**	(6,358,895)
Total capital assets, net	**10,561,456**	10,547,948
Other assets, net of current portion:		
Deposits, prepaid costs, and other (Note 8)	**241,919**	197,639
Total other assets	**241,919**	197,639
Total noncurrent assets	**11,222,933**	11,071,567
Deferred Outflows of Resources:		
Loss on bond refundings (Note 1p)	**45,255**	64,049
Loss on swap terminations (Note 1p)	**28,955**	33,821
Pension related (Note 1q)	**130,346**	48,475
Effective swaps (Note 1p)	**—**	7,996
Total deferred outflows of resources	**204,556**	154,341
Total Assets and Deferred Outflows of Resources	**$ 12,605,021**	$ 12,735,937

See accompanying notes to basic financial statements.

STATEMENTS OF NET POSITION

(Dollars in thousands)	December 31, 2017	2016
	(Unaudited)	
LIABILITIES, DEFERRED INFLOWS OF RESOURCES, AND NET POSITION		
Current Liabilities:		
Accounts payable and accrued expenses (Note 1i)	**$ 114,417**	$ 45,063
Revolving notes (Note 3a)	**—**	250,000
Current portion of long-term debt	**510,479**	325,338
Current portion of obligations for off-aqueduct power facilities (Note 6f)	**1,203**	3,265
Current portion of accrued compensated absences (Note 1j)	**19,800**	19,600
Current portion of customer deposits and trust funds	**4,885**	10,389
Current portion of workers' compensation and third party claims (Note 11)	**5,543**	9,500
Current portion of other long-term obligations	**133,731**	125,744
Accrued bond interest	**72,915**	76,816
Matured bonds and coupons not presented for payment	**1,760**	1,768
Total current liabilities	**864,733**	867,483
Noncurrent Liabilities:		
Long-term debt, net of current portion	**3,777,087**	4,226,281
Revolving Notes (Note 3a)	**198,265**	—
Obligations for off-aqueduct power facilities, net of current portion (Note 6f)	**9,028**	9,447
Accrued compensated absences, net of current portion (Note 1j)	**26,817**	26,709
Customer deposits and trust funds, net of current portion	**41,360**	87,934
Net pension liability (Note 4)	**587,662**	479,555
Postemployment benefits other than pensions (Note 5)	**60,815**	61,780
Workers' compensation and third party claims, net of current portion (Note 11)	**10,831**	11,504
Fair value of interest rate swaps (Note 3f)	**61,790**	72,823
Other long-term obligations, net of current portion	**2,225**	2,229
Total noncurrent liabilities	**4,775,880**	4,978,262
Total liabilities	**5,640,613**	5,845,745
Commitments and Contingencies (Note 6)	**—**	—
Deferred Inflows of Resources:		
Effective swaps (Note 1p)	**1,270**	—
Pension related (Note 1q)	**21,896**	40,121
Total deferred inflows of resources	**23,166**	40,121
Net Position (Note 10)**:**		
Net investment in capital assets, including State Water Project costs	**6,067,920**	5,986,208
Restricted for:		
Debt service	**218,965**	147,854
Other	**183,131**	183,184
Unrestricted	**471,226**	532,825
Total net position	**6,941,242**	6,850,071
Total Liabilities, Deferred Inflows of Resources, and Net Position	**$ 12,605,021**	$ 12,735,937

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STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

	Six Months Ended December 31,	
(Dollars in thousands)	**2017**	2016
Operating Revenues (Note 1c):	(Unaudited)	
Water sales	**$ 727,647**	$ 694,686
Readiness-to-serve charges	**67,500**	76,500
Capacity charge	**16,848**	22,868
Power sales	**15,061**	8,429
Total operating revenues	**827,056**	802,483
Operating Expenses:		
Power and water costs	**265,417**	224,755
Operations and maintenance	**237,847**	251,674
Total operating expenses	**503,264**	476,429
Operating income before depreciation and amortization	**323,792**	326,054
Less depreciation and amortization	**(151,003)**	(147,281)
Operating income	**172,789**	178,773
Nonoperating Revenues (Expenses) (Note 1m):		
Taxes, net (Note 1d)	**60,670**	56,272
Bond interest, net of $7,100 and $7,900 of interest capitalized fiscal year-to-date 2017 and 2016, respectively (Note 1g)	**(63,296)**	(65,728)
Investment income (loss), net	**5,740**	(3,257)
Other, net	**6,461**	152
Total nonoperating expenses, net	**9,575**	(12,561)
Income Before Contributions	**182,364**	166,212
Capital contributions (Note 1l)	**1,193**	77
Changes in net position	**183,557**	166,289
Net Position		
Net position, at June 30, 2017 and 2016	**6,757,685**	6,683,782
Net position, at December 31, 2017 and 2016	**$ 6,941,242**	$ 6,850,071

See accompanying notes to basic financial statements.

STATEMENTS OF CASH FLOWS

(Dollars in thousands)	Six Months Ended December 31, 2017	2016
Cash Flows from Operating Activities:	(Unaudited)	
Cash received from water sales	**$ 633,670**	$ 660,756
Cash received from readiness-to-serve charges	**60,456**	69,335
Cash received from capacity charge	**16,835**	29,329
Cash received from power sales	**17,494**	7,654
Cash received from other exchange transactions	**41,568**	39,629
Cash paid for operations and maintenance expenses	**(110,741)**	(149,491)
Cash paid to employees for services	**(157,564)**	(126,579)
Cash paid for power and water costs	**(260,154)**	(295,493)
Other cash flows for operating activities	**(1,998)**	(800)
Net cash provided by operating activities	**239,566**	234,340
Cash Flows from Noncapital Financing Activities:		
Proceeds from other collections	**3,338**	3,112
Net cash provided by noncapital financing activities	**3,338**	3,112
Cash Flows from Capital and Related Financing Activities:		
Acquisition and construction of capital assets	**(98,957)**	(294,724)
Payments for State Water Project costs	**(93,998)**	(76,176)
Proceeds from short and long-term debt	**79,833**	220,785
Payments for bond issuance costs	**(1,468)**	(1,663)
Principal paid on debt	**(395,085)**	(169,970)
Interest paid on debt	**(82,380)**	(83,122)
Payments for other long-term obligations	**(834)**	(3,214)
Proceeds from tax levy	**59,891**	48,700
Transfer to/from escrow trust accounts	**(27,456)**	(2,080)
Net cash used by capital and related financing activities	**(560,454)**	(361,464)
Cash Flows from Investing Activities:		
Purchase of investment securities	**(3,415,009)**	(5,613,917)
Proceeds from sales and maturities of investment securities	**3,725,443**	5,729,563
Investment income	**6,293**	8,471
Net cash provided by investing activities	**316,727**	124,117
Net change in cash	**(823)**	105
Cash at July 1, 2017 and 2016	**902**	39
Cash at December 31, 2017 and 2016 (Note 1b)	**$ 79**	$ 144

See accompanying notes to basic financial statements.

STATEMENTS OF CASH FLOWS

(Dollars in thousands)	Six Months Ended December 31, 2017	2016
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES	(Unaudited)	
Operating Income	**$ 172,789**	$ 178,773
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities:		
Depreciation and amortization expense	**151,003**	147,281
(Increase) decrease in accounts receivable	**(61,776)**	1,131
(Increase) decrease in inventories	**(6,831)**	15,933
Increase in deposits, prepaid costs, and other	**(113,932)**	(69,021)
Increase (decrease) in accounts payable and accrued expenses	**24,886**	(84,377)
Increase in other items	**73,427**	44,620
Total Adjustments	**66,777**	55,567
Net cash provided by operating activities	**$ 239,566**	$ 234,340
Significant Noncash Investing, Capital and Financing Activities		
Refunding bonds proceeds received in escrow trust fund	**$ 611,435**	$ 108,721
Debt defeased through escrow trust fund with refunding debt	**$ (598,260)**	$ (62,465)

RECONCILIATION OF CASH AND INVESTMENTS TO CASH		
Unrestricted cash and investments (at December 31, 2017 and 2016 include $79 and $144 of cash, respectively)	**$ 603,098**	$ 883,953
Restricted cash and investments	**458,444**	484,422
Total cash and investments, at fair value	**1,061,542**	1,368,375
Less: carrying value of investments	**(1,061,463)**	(1,368,231)
Total Cash (Note 1b)	**$ 79**	$ 144

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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. 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 than 38 directors. 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 six months ended December 31, 2017 and 2016. 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 a utility enterprise and 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.

Metropolitan is accounted for as an enterprise fund and applies all applicable Governmental Accounting Standards Board (GASB) pronouncements in its accounting and reporting.

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

Certain amounts reported in fiscal year 2017 have been reclassified to conform to the fiscal year 2018 presentation. Such reclassification had no effect on Metropolitan's net position or change in net position.

(c) Revenue Policies

Metropolitan's principal source of revenue is from water sales, which include revenues received from charges for the sale and availability of water, including water rates and other exchange transactions. 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 includes separate rates for supply, treatment, conveyance and distribution, power, and demand management. 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) 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 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 (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, tax levies in fiscal years 1991 to 2013, other than annexation taxes, were 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. During fiscal years 2018 and 2017, the Board suspended the tax rate limitations and maintained the fiscal year 2013 tax rate for fiscal years 2018 and 2017 to pay a portion of State Water Contract costs other than debt service.

(e) Other Receivables

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

(f) Inventories

Metropolitan's inventories are valued based on a moving-average cost. Expenses are recorded when inventories are used. Components of inventories at December 31, 2017 and 2016 were as follows:

	December 31,	
(Dollars in thousands)	**2017**	2016
Water in storage	**$ 105,577**	$ 65,857
Operating supplies	**11,787**	10,755
Total inventories	**$ 117,364**	$ 76,612

(g) Plant and Equipment

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, and distribution facilities, 10 to 50 years for treatment plants and hydroelectric power recovery facilities, and 10 to 80 years for miscellaneous assets. Improvements or refurbishments with aggregated costs that meet capitalization thresholds and that extend the useful life of an existing asset by at least five 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.

(h) Participation Rights

Metropolitan participates in various storage and water management programs entitling it to certain water rights. Projects include the State Water Project (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.)

(i) Disaggregation of Payable Balances

Accounts payable and accrued expenses at December 31, 2017 and 2016 were as follows:

	December 31,	
(Dollars in thousands)	**2017**	2016
Department of Water Resources (State Water Project):		
Capital, operating, maintenance, power, replacement, and variable power	**$ 75,058**	$ 14,304
Vendors	**30,020**	21,118
Accrued power costs	**5,065**	3,252
Conservation credits	**4,274**	6,389
Total accounts payable and accrued expenses	**$ 114,417**	$ 45,063

(j) 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.

(k) 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.

(l) 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.

(m) 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 water sales, 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.

(n) 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.

(o) Use of Estimates

The preparation of basic financial statements in conformity with U.S. generally accepted accounting principles 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.

(p) Deferred Outflows of Resources and Deferred Inflows of Resources

GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position* (GASB 63) requires that the difference between assets, deferred outflows of resources, liabilities, and deferred inflows of resources be reported as net position. In addition, the impact of deferred outflows of resources and deferred inflows of resources on net position must be explained as is done in the following paragraph.

The unrestricted net position amount of $471.2 million and $532.8 million at December 31, 2017 and 2016, respectively, includes the effect of deferring the recognition of losses from bond refundings, swap terminations resulting in defeasance of debt, and the increase or decrease in fair value of Metropolitan's effective interest rate swaps. The deferred outflows from losses on bond refundings at December 31, 2017 and 2016, respectively, were $45.3 million and $64.0 million, respectively. The deferred outflows from losses on swap terminations resulting in debt defeasance at December 31, 2017 and 2016, respectively, were $29.0 million and $33.8 million. Both 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 inflows from the increase in fair value of interest rate swaps of $1.3 million at December 31, 2017 and the deferred outflows from the decline in fair value of interest rate swaps of $8.0 million at December 31, 2016 would be recognized as an investment gain or loss, respectively, 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 inflow and the deferred outflow also would be recognized as an investment gain or loss, respectively, if the swaps were determined no longer to be effective hedges. Finally, if the bond associated with a swap is refunded, the deferred inflow or the deferred outflow would be reduced and the deferred gain or loss on refunding, respectively, would be increased by the same amount. The deferred gain or loss on refunding would be amortized as a component of interest expense over the life of the old debt or the new debt, whichever is shorter.

(q) Net Pension Liability, Deferred Outflows of Resources, Deferred Inflows of Resources, Pension Expense

GASB Statement No. 68, *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27* (GASB 68), provides requirements for how pension costs and obligations are measured and reported in the basic financial statements. When an organization's pension liability exceeds the pension plan's net position available for paying benefits, there is a net pension liability which must be reported in the basic financial statements. In addition, GASB 68 requires that projected benefit payments be discounted to their actuarial present value using a single rate that reflects (1) a long-term expected rate of return on pension plan investments to the extent that the pension plan's fiduciary net position is projected to be sufficient to pay benefits and pension plan assets are expected to achieve that rate and (2) a tax-exempt, high-quality municipal bond rate to the extent that the conditions under (1) are not met.

(r) Fair Value Measurement

GASB Statement No. 72, *Fair Value Measurement and Application* (GASB 72) requires a government to use valuation techniques that are appropriate under the circumstances and for which sufficient data are available to measure fair value. The techniques should be consistent with one or more of the following approaches: the market approach, the cost approach, or the income approach. Metropolitan has been reporting its investments and liabilities at fair value using market approach and cost approach therefore, there are no significant changes to its reporting resulting from the implementation of GASB 72 in fiscal year 2016.

Additionally, GASB 72 establishes a hierarchy of inputs to valuation techniques used to measure fair value. This hierarchy has three levels which are: 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—included within Level 1 that are observable for the asset or liability, 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. The fair value hierarchy to Metropolitan's assets and liabilities are presented in Note 2.

(s) New Accounting Pronouncements

Metropolitan implemented the following GASB Statement in the twelve months ended December 31, 2017:

In March 2016, the GASB issued Statement No. 82, *Pension Issues – an amendment of GASB Statements No. 67, No. 68, and No. 73* (GASB 82). This Statement addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements. GASB 82 requires the presentation of covered payroll, which is payroll on which contributions to a pension plan are based, and ratios that use that measure in required supplementary information instead of covered-employee payroll. In addition, GASB 82 clarifies that a deviation, as that term is used in Actuarial Standards of Practice, is not considered to be in conformity with the requirements of Statement 67, Statement 68, or Statement 73 for the selection of assumptions used in determining the total pension liability and related measures, based on the guidance in the Actuarial Standards of Practice. GASB 82 further clarify that payments that are made by an employer to satisfy contribution requirements that are identified by the pension plan terms as plan member contribution requirements should be classified as plan member contributions for purposes of Statement 67 and as employee contributions for purposes of Statement 68. It also requires that an employer's expense and expenditures for those amounts be recognized in the period for which the contribution is assessed and classified in the same manner as the employer classifies similar compensation other than pensions (for example, as salaries and wages or as fringe benefits).

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:

In June 2015, the GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* (GASB 75), which establishes new accounting and financial reporting requirements for OPEB improving the accounting and financial reporting by state and local governments for OPEB and provides information provided by state and local government employers about financial support for OPEB that is provided by other entities. This statement replaces the requirements of GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions and GASB 57- OPEB Measurements by Agent Multiple-Employer Plans*. GASB 75 is effective for Metropolitan's fiscal year ending June 30, 2018.

In March 2017, the GASB issued Statement No. 85, *Omnibus 2017* (GASB 85). The objective of this Statement is to address practice issues that have been identified during implementation and application of certain GASB Statements. This Statement addresses a variety of topics including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefits (OPEB)).

Specifically, this Statement addresses the following topics: (1) Blending a component unit in circumstances in which the primary government is a business-type activity that reports in a single column for financial statement presentation, (2) Reporting amounts previously reported as goodwill and "negative" goodwill, (3) Classifying real estate held by insurance entities, (4) Measuring certain money market investments and participating interest-earning investment contracts at amortized cost, (5) Timing of the measurement of pension or OPEB liabilities and expenditures recognized in financial statements prepared using the current financial resources measurement focus (6) Recognizing on-behalf payments for pensions or OPEB in employer financial statements, (7) Presenting payroll-related measures in required supplementary information for purposes of reporting by OPEB plans and employers that provide OPEB, (8) Classifying employer-paid member contributions for OPEB, (9) Simplifying certain aspects of the alternative measurement method for OPEB, (10) Accounting and financial reporting for OPEB provided through certain multiple-employer defined benefit OPEB plans. GASB 85 is effective for Metropolitan's fiscal year ending June 30, 2018.

The following pronouncements were issued by GASB but were determined to not have an impact on Metropolitan's financial statements:

- GASB Statement No. 81, *Irrevocable Split-Interest Agreements*
- GASB Statement No. 84, *Fiduciary Activities*
- GASB Statement No. 86, *Certain Debt Extinguishment Issues*
- GASB Statement No. 87, *Leases*

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 December 31, 2017 and 2016, Metropolitan's cash balances with financial institutions were $74,000 and $139,000 respectively, and 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, repurchase agreements, negotiable certificates of deposit, bankers' acceptances, prime commercial paper, asset and mortgage-backed securities, California local agency securities, including securities issued by Metropolitan, medium-term corporate notes, time deposits, investment contracts, shares of beneficial interest, and Local Agency Investment Fund (LAIF). As of December 31, 2017 and 2016, Metropolitan had the following investments at fair value:

	December 31,	
(Dollars in thousands)	**2017**	2016
U.S. Treasury securities	**$ 311,713**	$ 342,211
U.S. Guarantees – GNMAs	**3**	4
Federal agency securities	**66,688**	141,213
Bankers' acceptances	—	103
Prime commercial paper	**168,693**	238,595
Medium-term corporate notes	**159,638**	111,417
Negotiable certificates of deposit	**222,394**	359,341
Shares of beneficial interest	**845**	496
Government-sponsored enterprise (GSE)	**58,197**	62,866
Municipal bonds	**22,159**	46,985
Local Agency Investment Fund	**51,133**	65,000
Total investments	**$ 1,061,463**	$ 1,368,231

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

The following is the summary of the fair value hierarchy of the fair value of investments of Metropolitan as of December 31, 2017 and 2016:

	Fair Value Measurement Using							
(Dollars in thousands)	**12/31/17**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Obervable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	12/31/16	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Obervable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Investments by fair value level:								
U.S. Treasury securities	**$ 311,713**	**$ 311,713**	**$ —**	**$ —**	$ 342,211	$ 342,211	$ —	$ —
U.S. Guarantees – GNMAs	**3**	**3**	**—**	**—**	4	4	—	—
Federal agency securities	**66,688**	**66,688**	**—**	**—**	96,247	96,247	—	—
Bankers' acceptances	**—**	**—**			103	—	103	—
Prime commercial paper	**168,693**	**92,818**	**75,875**	**—**	238,595	102,079	136,516	—
Medium-term corporate notes	**159,638**	**159,638**	**—**	**—**	111,417	111,417	—	—
Negotiable certificates of deposit	**222,394**	**117,217**	**105,177**	**—**	359,341	359,341	—	—
Shares of beneficial interest (1)	**845**	**—**	**—**	**845**	496	—	—	496
Government-sponsored enterprise (GSE)	**58,197**	**58,197**	**—**	**—**	62,866	62,866	—	—
Municipal bonds	**22,159**	**22,159**	**—**	**—**	46,985	46,985	—	—
Total investments by fair value level	**$ 1,010,330**	**$ 828,433**	**$ 181,052**	**$ 845**	$ 1,258,265	$ 1,121,150	$ 136,619	$ 496
Investments not subject to fair value level:								
Federal agency securities	**—**				44,966			
Local Agency Investment Fund	**51,133**				65,000			
Total investments	**$ 1,061,463**				$ 1,368,231			

(1) As of December 31, 2017 and 2016, the balance was invested in BlackRock Treasury Trust (TTTXX).

Investments classified in Level 1 of the fair value hierarchy, valued $828.4 million and $1.1 billion as of December 31, 2017 and 2016, respectively, are valued using quoted prices in active markets.

Prime commercial paper totaling $75.9 million and $136.5 million as of December 31, 2017 and 2016, respectively, negotiable certificates of deposit totaling $105.2 million, as of December 31, 2017, and banker's acceptance totaling $103,000 as of December 31, 2016, classified in Level 2 of the fair value hierarchy were valued using matrix pricing.

Shares of beneficial interest totaling $0.8 million and $0.5 million as of December 31, 2017 and 2016, respectively, classified in Level 3 of the fair value hierarchy was valued at Fund's share price of $1.00.

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 Bank of America Merrill Lynch 3-Month Treasury Bill Index, approved by the Finance and Insurance Committee. For December 31, 2017 and 2016, the benchmark duration was 0.24, and the portfolio duration was permitted to vary from the duration by plus or minus 0.20. As of December 31, 2017 and 2016, Metropolitan's investments and portfolio durations for this segment were as follows:

	December 31,			
	2017		2016	
(Dollars in thousands)	**Fair value**	**Duration**	Fair value	Duration
U.S. Treasury securities	**$ 83,607**	**0.67**	$ 112,419	0.59
Federal agency securities	**60,099**	**0.58**	131,851	0.09
Bankers' acceptances	**—**	**—**	103	0.02
Prime commercial paper	**168,693**	**0.02**	238,340	0.15
Medium-term corporate notes	**86,854**	**0.08**	45,003	0.17
Negotiable certificates of deposit	**222,044**	**0.12**	359,166	0.22
Municipal bonds	**1,470**	**4.52**	16,367	0.31
Local Agency Investment Fund	**51,133**	**—**	65,000	—
Portfolio duration		**0.20**		0.21

Externally Managed Segment

This segment of the portfolio was managed against the Bank of America Merrill Lynch, U.S. Corporate and Government, one to five years, A-Rated and above index approved by the Finance and Insurance Committee. For December 31, 2017 and 2016, the benchmark durations were 2.64 and 2.69, respectively, and the portfolio duration was permitted to vary from the duration by plus or minus 1.50. As of December 31, 2017 and 2016, Metropolitan's investments and portfolio durations for this segment were as follows:

	December 31,			
	2017		2016	
(Dollars in thousands)	**Fair value**	**Duration**	Fair value	Duration
U.S. Treasury securities	**$ 210,979**	**2.65**	$ 208,332	2.78
U.S. Guarantees – GNMAs	**3**	**4.10**	4	4.71
Federal agency securities	**6,341**	**9.14**	7,219	5.69
Medium-term corporate notes	**69,944**	**3.06**	63,394	2.05
Shares of beneficial interest	**842**	**—**	496	—
Government-sponsored enterprise (GSE)	**58,197**	**2.35**	62,866	2.23
Portfolio duration		**2.79**		2.61

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 December 31, 2017 and 2016, Metropolitan's investments and portfolio durations for this segment were as follows:

	December 31,			
	2017		2016	
(Dollars in thousands)	**Fair value**	**Duration**	Fair value	Duration
U.S. Treasury securities	**$ 17,127**	**3.83**	$ 21,460	4.82
Federal agency securities	**248**	**0.28**	2,143	0.97
Negotiable certificates of deposit	**350**	**0.06**	175	0.14
Medium-term corporate notes	**2,840**	**0.13**	3,020	0.16
Municipal bonds	**20,689**	**5.45**	30,618	5.13
Prime commercial paper	**—**	**—**	255	0.19
Shares of beneficial interest	**3**	**—**	—	—
Weighted average duration		**4.34**		4.56

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. Government and agencies	Not applicable.
Bankers' acceptances Prime commercial paper Negotiable certificates of deposit Time deposits	Prime quality of the highest ranking or highest letter and numerical rating ('A1', 'P1', 'F1' or higher) as provided by Moody's Investors Service, Inc., Standard & Poor's Global Ratings Services, and Fitch Ratings. Credit requirement may be waived for the maximum deposit that is insured by the Federal Deposit Insurance Corporation.
Repurchase agreements	Only with primary dealers in government securities or financial institutions with a Moody's Investors Service, Inc. or equivalent rating of 'A' or better.
Investment contracts	Not applicable. Limited to guaranteed investment contracts, or agreements collateralized with U.S. Treasury or agency securities.
Medium-term corporate notes	Rating category of at least 'A' or better, or the equivalent, by a nationally recognized rating agency.
Government-sponsored enterprise (e.g., FannieMae, FreddieMac)	Issuer's debt must be rated 'A' or higher as provided by a nationally recognized rating agency and the security must be rated in a category of 'AAA' by a nationally recognized rating agency.
Local Agency Investment Fund	Not applicable.
Shares of beneficial interest	Highest ranking of the highest letter and numerical rating provided by not less than two nationally recognized rating agencies.
California local agency securities Municipal bonds	Securities with a maturity in excess of five years must have a credit rating of at least 'AA' (may be insured) and an underlying credit rating of 'A' or better by a nationally recognized rating agency.

Metropolitan's minimum rating for assets and mortgage-backed securities of 'AAA' is more restrictive than the California Government Code requirement of 'AA'.

At December 31, 2017 and 2016, Metropolitan's portfolio was invested in the following securities by rating:

		December 31,	
		2017	2016
(Dollars in thousands)	Rating	**Fair value**	Fair value
U.S. Treasury securities	AAA[1]	**$ 311,713**	$ 342,211
U.S. Guarantees – GNMAs	AAA	**3**	4
Federal agency securities	AAA[1]	**66,688**	141,213
Shares of beneficial interest	AAA	**845**	496
Government-sponsored enterprise (GSE)	AAA	**58,197**	62,866
Medium-term corporate notes	A[2]	**159,638**	111,417
Prime commercial paper	A1/P1[2]	**168,693**	238,595
Negotiable certificates of deposit	F1[2]	**222,394**	359,341
Bankers' acceptances	F1(2)	**—**	103
Municipal bonds	A[2]	**22,159**	46,985
Local Agency Investment Fund	[3]	**51,133**	65,000
Total portfolio		**$ 1,061,463**	$ 1,368,231

(1) *United States Treasuries and Federal Agencies are rated "AAA" by two nationally recognized rating agencies and "AA" by one nationally recognized rating agency.*

(2) *A or better e.g. F1+, A1+, AA, or AAA.*

(3) *Local Agency Investment Fund 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 asset and mortgage-backed securities, to 100 percent for U.S. Treasury and agency securities. The percentages of investments that can be purchased by a single issuer, within each security type, ranged from 5 percent, for asset-backed securities, to 10 percent for bankers' acceptances.

The following table identifies Metropolitan's limits and the percent invested by security type based on fair value, as of December 31, 2017 and 2016:

	Investment Policy Limits	Percent of Portfolio	
		2017	2016
U.S. Treasury securities	100%	**29.37 %**	25.01 %
Federal agency securities	100%	**6.28**	10.32
Shares of beneficial interest	20%	**0.08**	0.04
Government-sponsored enterprise (GSE)	20%	**5.48**	4.60
Medium-term corporate notes	30%	**15.04**	8.14
Prime commercial paper	25%	**15.89**	17.44
Negotiable certificates of deposit	30%	**20.95**	26.26
Bankers' acceptances	40%	—	0.01
Municipal bonds	30%	**2.09**	3.43
Local Agency Investment Fund	N/A	**4.82**	4.75
Total portfolio		**100.00 %**	100.00 %

At December 31, 2017 and 2016, 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)	December 31, 2017		December 31, 2016	
Bank of Nova Scotia	**$ —**	**— %**	$ 75,055	5.49 %
Local Agency Investment Fund	**$ 73,521**	**6.93 %**	$ —	— %
Federal National Mortgage Association	**$ 55,878**	**5.26 %**	$ —	— %
Sumitomo Mitsui	**$ 55,445**	**5.22 %**	$ —	— %

Custodial credit risk. At December 31, 2017 and 2016, 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 $51.1 million and $65.0 million in deposits in the California State managed LAIF as of December 31, 2017 and 2016, respectively.

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 Chairman is the State Treasurer, or his designated representative.

The total amount invested by all public agencies in LAIF as of December 31, 2017 and 2016 was $21.2 billion and $21.6 billion, respectively. At December 31, 2017 and 2016, the PMIA portfolio balance was $74.3 billion and $73.7 billion, respectively, of which, 3.59 percent and 1.62 percent were invested in medium-term and short-term notes and asset-backed securities, respectively. The average maturity of LAIF investments as of December 31, 2017 and 2016 was 186 days and 171 days, respectively.

(c) Reverse Repurchase Agreements

Metropolitan was 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 two years ended December 31, 2017 and 2016.

(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 were classified as "restricted." Most restricted accounts had the minimum cash and investment balance requirements and all were nondiscretionary in terms of the use of assets. Among other things, the restricted amounts provided 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 $4.486 billion and $4.802 billion at December 31, 2017 and 2016, respectively, represents less than one percent of the June 30, 2017 and 2016 total taxable assessed valuation of $2,741 billion and $2,583 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) Short-term Debt

Metropolitan may issue up to $400.0 million in commercial paper to fund a portion of its capital plan. During the fiscal years ended December 31, 2017 and 2016, there were no commercial paper notes issued or outstanding. Metropolitan may also issue other forms of short-term debt such as variable rate water revenue bonds (see Note 3c).

In April 2016, Metropolitan entered into a noteholder's agreement with RBC Municipal Products, LLC ("RBC") for the purchase by RBC and sale by Metropolitan of Metropolitan's Index Notes, Series 2016 ("RBC Facility"). Also in April 2016, Metropolitan entered into a note purchase and continuing covenant agreement with U.S. Bank National Association ("US Bank"), for the purchase by US Bank and sale by Metropolitan of Metropolitan's Flexible Rate Revolving Notes, Series 2016 ("US Bank Facility," and together with the RBC Facility, the "Short-Term Revolving Credit Facilities"). Metropolitan is permitted to sell up to $200.0 million of notes under each of the Short-Term Revolving Credit Facilities for an aggregate amount of available borrowings of $400.0 million. Metropolitan may borrow, pay down and re-borrow amounts under each of the Short-Term Revolving Credit Facilities. As of December 31, 2016, Metropolitan has sold $250.0 million of notes under the Short-Term Revolving Credit Facilities ($125.0 million under the RBC Facility and $125.0 million under the US Bank Facility). On April 3, 2017, Metropolitan sold $250.0 million of notes under the Short-Term Revolving Credit Facility ($125.0 million under the RBC Facility and $125.0 million under the US Bank Facility), to refund the notes issued in 2016. The $125.0 million note issued in 2017 under the RBC Facility has a maturity date of April 5, 2020 and the $125.0 million note issued in 2017 under the US Bank Facility has a maturity date of April 5, 2019. On July, 1 2016, Metropolitan sold $45.8 million of Notes under the US Bank Facility to refund $31.2 million of Water Revenue Refunding Bonds, 2012 Series E-3 and $14.6 million of Water Revenue Refunding Bonds, 2014 Series G-1. The Notes were refunded on September 20, 2016 from proceeds of $103.7 million of Special Variable Rate Water Revenue Refunding Bonds, 2016 Series B-1 and B-2. On June 1, 2017, Metropolitan sold $12.3 million of notes under the US Bank Facility, to refund $12.3 million of Special Variable Rate Water Revenue Refunding Bonds, 2013 Series E. These notes were refunded on July 3, 2017 from the proceeds of the $178.2 million of Subordinate Water Revenue Refunding Bonds, 2017 Series B. On November 1, 2017, Metropolitan prepaid the $125.0 million Taxable Flexible Rate Refunding Notes, Series A-1 and the $125.0 million Taxable and Refunding Subseries 2017 Series B-1 Notes.

Each of the Short-Term Revolving Credit Facilities bears interest at a variable rate of interest. The US Bank Facility bears interest at a basis point spread to one-month London interbank offering rate (LIBOR) for taxable borrowings or to 70 percent of one-month LIBOR for tax-exempt borrowings, while the RBC Facility bears interest at a spread to one-month LIBOR for taxable borrowings or to the SIFMA Municipal Swap Index for tax-exempt borrowings. Under the Short-Term Revolving Credit Facilities, upon a failure by Metropolitan to perform or observe its covenants, a default in other specified indebtedness of Metropolitan, or other specified events of default, each bank could terminate its commitments and declare all amounts then outstanding to be immediately due and payable. Metropolitan has secured its obligation to pay principal and interest under the Short-Term Credit Facilities as Senior Parity Obligations.

(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 plan. The original amounts, issued as Series A through H under the 1966 authorization, totaled $850.0 million at December 31, 2017 and 2016. Metropolitan has refunded a portion of these general obligation bond issues through the issuance of refunding bonds. A total of $74.9 million and $92.9 million in general obligation bonds and general obligation refunding bonds were outstanding at December 31, 2017 and 2016, respectively.

The general obligation and general obligation refunding bond issues include both serial and term bonds that mature in varying amounts through March 2037 at interest rates ranging from 4.0 percent to 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.

No general obligation bonds were issued during the twelve months ended December 31, 2017 and 2016.

(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 $4.008 billion and $4.235 billion of revenue bonds and revenue refunding bonds were outstanding at December 31, 2017 and 2016, 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 July 2047 at interest rates ranging from 1.49 percent to 6.95 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 interest payment dates, and subject to early redemption.

Revenue bonds issued during the twelve months ended December 31, 2017 were as follows:

- On March 1, 2017, Metropolitan issued $80.0 million of Water Revenue Bonds, 2017 Authorization Series A, at variable rates, to finance a portion of Metropolitan's capital expenditures. The maturities extend to July 1, 2047 and are subject to optional and mandatory redemption provisions.

- On July 3, 2017, Metropolitan issued $80.0 million of Subordinate Water Revenue Bonds, 2017 Series C (SIFMA Index Mode), to finance a portion of Metropolitan's capital expenditures. The maturities extend to July 1, 2047 and are subject to optional and mandatory redemption provisions.

Revenue bond issued during the twelve months ended December 31, 2016 was as follows:

- On December 20, 2016, Metropolitan entered into a Continuing Covenant Agreement with Bank of America, N.A. (BANA, and the 2016 BANA Agreement), for the purchase by BANA and sale by Metropolitan of Metropolitan's $175.0 million Subordinate Water Revenue Bonds, 2016 Authorization Series A (the Subordinate 2016 Series A Bonds), which is the first series of bonds issued under the Subordinate Debt Resolution. Proceeds were used to reimburse Metropolitan for the purchase of the Delta Wetlands Properties in the San Francisco Bay\Sacramento-San Joaquin River Delta that was funded from Metropolitan's reserves in July 2016. The Subordinate 2016 Series A Bonds are Index Tender Bonds and bear interest at a variable rate of interest, at a spread to one-month LIBOR. Under the 2016 BANA Agreement, upon a failure by Metropolitan to perform or observe its covenants, a default in other specified indebtedness of Metropolitan, or other specified events of default, BANA could terminate its commitments and declare all amounts then outstanding to be immediately due and payable. Metropolitan has secured its obligation to pay principal and interest under the 2016 BANA Agreement as a Subordinate Lien Parity Obligation.

  The Subordinate 2016 Series A Bonds are subject to mandatory tender for purchase on the scheduled mandatory tender date of December 21, 2018, 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.

(d) Bond Refundings and Defeasances

Metropolitan has issued Waterworks General Obligation Refunding Bonds, Water Revenue Refunding Bonds, and Special Variable Rate Water Revenue Refunding Bonds to refund various issues of Waterworks General Obligation Bonds, Waterworks General Obligation Refunding Bonds, Water Revenue Bonds, Water Revenue Refunding Bonds, and Special Variable Rate Water Revenue Refunding Bonds 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) Other Long-term Debt

In November 2003, Metropolitan received $20.0 million through the state Department of Water Resources for oxidation retrofit facilities at the Mills Water Treatment Plant in Riverside County. This 20-year State Revolving Fund loan carries interest at 2.39 percent with the final payment due July 1, 2024. On June 1, 2017, the State Revolving Fund loan was refunded from proceeds of the $238.0 million Subordinate Water Revenue Refunding Bonds, 2017 Series A. At December 31, 2017 and 2016, the outstanding balance was $0 and $8.6 million, respectively.

(f) Interest Rate Swaps

Metropolitan has eight outstanding interest rate swap agreements as of December 31, 2017. 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 December 31, 2017 and 2016, 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 December 31, 2017, 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 December 31, 2017.

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 December 31, 2017, Metropolitan has pay-fixed, receive-variable swap transactions with one counterparty in the amount of $216.0 million or 43.8 percent of the notional amount of Metropolitan's outstanding pay-fixed, receive-variable swap transactions. This counterparty is rated Aa3/A+/AA- by Moody's, Standard & Poor's, 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 December 31, 2017, the interest rates of the variable rate debt associated with these swap transactions range from 1.60 percent to 1.76 percent. Metropolitan's variable rate payments received from the counterparties of these swaps ranged from 0.90 percent to 1.19 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.

(h) Variable Rate Bonds

The variable rate bonds bear interest at daily and weekly rates ranging from 1.60 percent to 1.95 percent as of December 31, 2017 and 0.66 percent to 1.16 percent as of December 31, 2016. Metropolitan can elect to change the interest rate period of the bonds with certain limitations. With the exception of the Subordinate Water Revenue Bonds, 2017 Series C (SIFMA Index Mode), the Subordinate Water Revenue Refunding Bonds, 2017 Series D and 2017 Series E (SIFMA Index Mode), the 2011 SIFMA Index Bonds Series A-2 and A-4, the 2012 SIFMA Index Bonds Series B-1 and B-2, and the Subordinate Water Revenue Bonds, 2016 Authorization Series A, the bondholders have the right to tender bonds to the paying agent on any business day with same day notice. The current terms of the Subordinate Water Revenue Bonds, 2017 Series C (SIFMA Index Mode), the Subordinate Water Revenue Refunding Bonds, 2017 Series D and 2017 Series E (SIFMA Index Mode) provide bondholders a right to tender bonds to the paying agent every 380 days and for the 2011 SIFMA Index Bonds Series A-2 and A-4, and the 2012 SIFMA Index Bonds Series 2012 B-1 and B-2, every three years. The Subordinate Water Revenue Bonds, 2016 Authorization Series A bonds are not subject to an optional tender by bondholders. Metropolitan has entered into standby bond purchase agreements (SBPA) with commercial banks to provide liquidity for three and two separate variable rate bond issues in the amount of $272.5 million and $192.5 million as of December 31, 2017 and 2016, respectively. In addition, Metropolitan has twelve and eleven series of variable rate bonds in the amounts of $959.3 million and $850.8 million as of December 31, 2017 and 2016, respectively, which are not supported by an SBPA.

The Bank Bonds that would be issued under the SBPA would bear interest that is payable at a rate, depending on the agreement, that is the higher of the "base rate", which is based on the Fed Funds Rate plus 2.00% per annum, or the Prime Rate plus 1.00% per annum, plus a spread of 7.0 percent, or LIBOR, plus a spread of 7.5 percent. The principal of the Bank Bonds would be payable, depending on the agreement, either ten equal semi-annual installments commencing 180 days after purchase by the bank, or in two equal semi-annual installments commencing six months after purchase by the bank.

The $103.7 million 2016 Series B-1 and B-2 bonds have SBPAs that expire on September 19, 2019 and the $80.0 million Water Revenue Bonds, 2017 Authorization, Series A, and the $88.8 million 2000 Series B-3, Water Revenue Bonds, have SBPAs that expire on March 27, 2020. According to the provisions of the Paying Agent Agreement for the bonds, the Paying Agent will draw on the SBPA two business days prior to the SBPA expiration to redeem all outstanding bonds. Metropolitan is required to repay the bank in either ten or two semi-annual installments commencing either 180 days or six months after the draw on the facility.

For three series of subordinate variable rate bonds not supported by SBPA in the amount of $271.3 million, non-payment of 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, constitutes an Event of Default under the Master Subordinate Resolution. For four series of variable rate bonds not supported by SBPA in the amount of $198.3 million, if the purchase price is not paid from the proceeds of remarketing or other funds, such bonds then will bear interest at a rate equal to the lower of (i) 12.0 percent and (ii) the higher of 8.0 percent or Prime Rate plus 3.0 percent until purchased by Metropolitan or redeemed pursuant to a special mandatory redemption. The principal amount of these new bonds would be payable in three equal installments at 18 month increments from the conversion of the bonds to a fixed rate.

The three series of self-liquidity variable rate bonds that were not supported by a SBPA at December 31, 2017 and 2016 were the $87.4 million, 2013 Series D, Special Variable Rate Water Revenue Refunding Bonds, the $38.5 million, 2014 Series D, Special Variable Rate Water Revenue Refunding Bonds, and the $188.9 million, 2015 Series A-1 and A-2, Special Variable Rate Water Revenue Refunding Bonds. These variable rate bonds outstanding at December 31, 2017 and 2016 had no long-term take out provisions therefore the entire principal amount of $314.8 million may be tendered for purchase upon one week's notice from bondholders. However, on July 1, 2015, Metropolitan entered into a Revolving Credit Agreement (RCA), by which Metropolitan may borrow up to $180.0 million, to pay the purchase price (principal and accrued interest) of any self-liquidity bonds tendered for purchase. The RCA permits repayment of any borrowed funds over a term-out period beginning 120 days after the stated expiration date of June 24, 2018. As a result of the RCA, only $134.8 million of these self-liquidity bonds have been classified as current liabilities as of December 31, 2016. As of December 31, 2017, the full $314.8 million was reported as current liabilities as the RCA is expiring in less than one year.

On December 18, 2017, Metropolitan sold $198.3 million of tax-exempt variable rate parity obligations under the Short-Term Revolving Credit Facility with US Bank to refund $49.8 million of Water Revenue Refunding Bonds, 2011 Series A-2, $49.8 million of Water Revenue Refunding Bonds, 2011 Series A-4, $49.3 million of Water Revenue Refunding Bonds, 2012 Series B-1, and $49.3 million of Water Revenue Refunding Bonds, 2012 Series B-2. The $198.3 million Tax-Exempt Flexible Rate Refunding Notes, Series 2016 B-2 pay a variable rate at a basis point spread to the SIFMA Municipal Swap Index. The US Bank Notes have a maturity date of December 17, 2018. The Short-Term Revolving Credit Facilities require US Bank and RBC to purchase refunding notes, subject to certain terms and conditions, through the Facilities expiration date of April 5, 2019. The maturity date of April 5, 2020 for the RBC Note will only be effective if RBC agrees, at its option, to extend the expiration of its Credit Facility to April 5, 2020.

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

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 CalPERS California Employers' Retiree Trust (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. This benefit was provided to 1,703 and 1,598 retired Metropolitan employees at December 31, 2017 and 2016, respectively. 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.

(b) Funding Policy

Contribution requirements are negotiated between Metropolitan and its various bargaining units. During the six months ended December 31, 2017, Metropolitan contributed up to 100 percent of Blue Shield Access + HMO Bay area regional basic plan rate for represented retirees and up to 90 percent of the PERS Care PPO Los Angeles regional basic plan rate for unrepresented retirees. Metropolitan contributed, net of participant contributions as determined by CalPERS, $30.1 million and $29.3 million, as of December 31, 2017 and 2016, respectively.

6. COMMITMENTS AND CONTINGENCIES

(a) State Water Contract (see Note 7)

Estimates of Metropolitan's share of the projected fixed costs of the State Water Project (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:

	State Water Contract Payments
Year ending June 30:	
2018	$ 432,439,455
2019	448,303,024
2020	463,444,213
2021	458,433,243
2022	455,875,879

Metropolitan intends to exercise its option to extend its agreement with the State through 2052, which will result in annual minimum operations and maintenance costs through 2052. 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, other than the $10.8 million obligation related to loss accruals on certain-off aqueduct power facilities (see Note 6f), 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 (Delta Vision 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. Currently, the DSC is providing for the public review of the Draft Program EIR for the latest Delta Plan Amendments. The PEIR was released on November 1, 2017 with the public comments due on January 22, 2018. As an informational document, this Draft PEIR provides full disclosure to the public and Council regarding the potential significant environmental effects of the Proposed Project consisting of three proposed amendments to the Delta Plan including Delta Levee Investment and Risk Reduction Strategy Amendment, Conveyance, Storage Systems, and the Operation of Both Amendment, and Performance Measures Amendment. The Draft PEIR is also intended to provide sufficient information to foster informed decision making by the Council.

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 and California EcoRestore. Under the California WaterFix, the new water conveyance facilities with proposed design changes would be constructed and operated. With the California EcoRestore, the focus would be on environmental restoration programs. After extensive consultation with the California Department of Water Resources (DWR) and U.S. Bureau of Reclamation (Reclamation), the National Marine Fisheries Service (NOAA Fisheries) and U.S. Fish and Wildlife Service (USFWS) issued their biological opinions for the proposed California WaterFix in June 2017. These agencies are responsible for the protection of species listed under the U.S. Endangered Species Act (ESA). Also, the California Department of Fish and Wildlife issued its permit under the State Endangered Species Act on July 28. The biological opinions found the construction and operation of California WaterFix as proposed would not jeopardize the continued existence of ESA-listed species or destroy or adversely modify critical habitat for those species. On July 21, the DWR issued its Notice of Determination (NOD) for California WaterFix, indicating that the project meets the requirements of the California Environmental Quality Act (CEQA). Following these milestone approvals, staff presented to the Board a series of three policy papers on infrastructure, operations and finance and cost allocation during the last quarter of 2017. On October 10, 2017, the Board of Directors approved Metropolitan's participation in the California WaterFix project for a defined 25.9 percent share. Eleven other State Water Contractors have taken formal board actions to support the California WaterFix project. Further work lies ahead on financing and implementation strategies.

(c) Imperial Irrigation District

As of December 31, 2017, Metropolitan had advanced to the Imperial Irrigation District (IID) a total of $320.8 million 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 85,000-105,000 acre-feet in 2018 and annually thereafter depending upon the amount used by the Coachella Valley Water District. A total of at least 85,000 and 86,900 acre-feet was available in calendar years 2017 and 2016, 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 (QSA) (see Note 6e). The amended Transfer Agreement sets the maximum transfer amount at 205,000 acre-feet in 2021, with the transfer gradually ramping up to that amount over an approximately twenty-year period, stabilizing at 200,000 acre-feet per year beginning in 2023.

No facilities exist to provide for delivery of water directly from IID to SDCWA. The Transfer Agreement provides that IID water be delivered to SDCWA through existing facilities owned by Metropolitan. On November 10, 1998, the boards of directors of Metropolitan and SDCWA authorized execution of an exchange contract (the Exchange Agreement), pursuant to which 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 water allocated to SDCWA that has been conserved as a result of the lining of the All-American and Coachella Canals. Metropolitan delivers an equal volume of water from its own sources of supply through portions of its delivery system to SDCWA. The deliveries to both Metropolitan and SDCWA are deemed to be made in equal monthly increments. In consideration for the conserved water made available to Metropolitan by SDCWA, a lower price is paid by SDCWA for the Exchange Agreement water delivered by Metropolitan. The price payable by SDCWA is based on 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 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 new lawsuit challenging the rates adopted by Metropolitan on April 10, 2012 and effective on January 1, 2013 and January 1, 2014. On May 30, 2014, SDCWA filed a lawsuit challenging the rates adopted by Metropolitan on April 8, 2014 and effective on January 1, 2015 and January 1, 2016. On April 13, 2016, SDCWA filed a new lawsuit challenging the rates and charges adopted by Metropolitan on April 12, 2016 and effective on January 1, 2017 and January 1, 2018. 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 below.

(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, the Coachella Valley Water District (CVWD), and Metropolitan. It also provides for specific acquisitions of conserved water and water supply arrangements for up to 75 years and restores the opportunity for Metropolitan to receive any special surplus water.

(f) Abandoned Off-Aqueduct Power Facilities

The California Department of Water Resources (DWR) has financed the construction of certain off-aqueduct power facilities in order to provide power for water transportation purposes for the State Water Project system. Two geothermal facilities have been abandoned by DWR due to insufficient steam supply to operate the plants at their planned capacities. As a result of these actions by DWR, Metropolitan recorded losses of $204.1 million in prior fiscal years.

(g) Construction Programs and Contracts

The estimated cost, excluding contingencies, of Metropolitan's capital program for fiscal years 2018 through 2022 totals approximately $1.22 billion. However, due to various uncertainties such as lower than anticipated construction bids, permitting delays, and facility shutdowns constraints, anticipated spending is forecasted at $200.0 million per year for the next 4 years and $205.0 million in fiscal year 2022.

Over the next three years, approximately $731.0 million is budgeted in the capital program, with over $600 million planned for major efforts such as seismic retrofits and mechanical and electrical refurbishments to major components of the Colorado River Aqueduct and three of Metropolitan's oldest treatment plants, rehabilitation through relining of the Prestressed Concrete Cylinder Pipe portions of the Second Lower and Sepulveda feeders, replacement/upgrade to the Supervisory Control and Data Acquisition (SCADA) system, and construction of the Advanced Water Treatment Demonstration Plant, a pilot effort to evaluate the feasibility of developing a regional wastewater recycling facility as an additional source of water supply to Southern California.

With the completion of all major construction under the Oxidation Retrofit Program, over the next 3 years the capital budget includes $7.6 million of estimated costs for facilities that may be required to meet current water quality standards (see Note 6i).

(h) 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 alleged 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 alleged overcharge to SDCWA by at least $24.5 million per year. The complaint alleged that all State Water Project 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 stated 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 charges. Rates in effect in prior years were not challenged in this lawsuit. Metropolitan contended that its rates adopted April 13, 2010 were reasonable, equitably apportioned among its member agencies and lawful and were adopted under a valid rate structure and cost of service approach.

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 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 this Exchange Agreement from calculation of SDCWA's preferential rights to purchase Metropolitan supplies and illegality of a "rate structure integrity" provision in conservation and local resources incentive agreements between Metropolitan and SDCWA. SDCWA filed a Second Amended Petition for Writ of Mandate and Complaint on April 17, 2012, which contains 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 Metropolitan's rates, adopted in April 2012, violate Proposition 26. Metropolitan contended that its rates adopted on April 10, 2012 were reasonable, equitably apportioned among its member agencies and lawful and were adopted under a valid rate structure and cost of service approach.

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. This ruling does not affect SDCWA's separate challenge to Metropolitan's rates adopted in April 2012, which also includes Proposition 26 allegations. On December 4, 2013, the court granted Metropolitan's motion for summary adjudication of the cause of action alleging illegality of the "rate structure integrity" provision in conservation and local resources incentive agreements, dismissing this claim in the first lawsuit.

Trial of the first phase of both lawsuits concluded January 23, 2014. This phase concerned the challenges to Metropolitan's rates. On April 24, 2014, the court issued its "Statement of Decision on Rate Setting Challenges," determining that SDCWA prevailed on two of its claims and that Metropolitan prevailed on the third claim. The court found that there was not sufficient evidence in the administrative record to support Metropolitan's inclusion in its transportation rates, and hence in its wheeling rate, of 100 percent of (1) payments it makes to the California Department of Water Resources for transportation charges related to the State Water Project, or (2) the costs incurred by Metropolitan for conservation and local water supply development programs recovered through the

Water Stewardship Rate. The court found that SDCWA failed to prove its "dry-year peaking" claim that Metropolitan's rates do not adequately account for variations in member agency purchases.

SDCWA's claims asserting breach of the Exchange Agreement and miscalculation of preferential rights were tried in a second phase of the case which concluded April 30, 2015. On August 28, 2015, the trial court issued a final statement of decision for the second phase. The decision found in favor of SDCWA on both claims and that SDCWA is entitled to contract damages in the amount of nearly $188.3 million. On October 9 and 30, 2015, the trial court granted SDCWA's motion for prejudgment interest at the statutory rate of 10 percent on these damages. The prejudgment interest award through entry of judgment was $46.6 million. Based on the trial court decision, after entry of judgment, post-judgment interest began accruing at the statutory rate of 7 percent. On November 18, 2015, the court issued the Final Judgment and a Peremptory Writ of Mandate in the 2010 and 2012 SDCWA v. Metropolitan cases. On January 21, 2016, the court awarded $320,084 in costs to SDCWA, after deducting amounts based on Metropolitan's motion. On March 24, 2016, the court awarded $8.9 million in attorneys' fees to SDCWA, rejecting its demand for over $17.0 million. Metropolitan filed a Notice of Appeal of the Judgment and Writ in each case and SDCWA filed a Notice of Cross-Appeal of the court's ruling on the rate structure integrity claim and the 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 State Water Project transportation costs in the System Access Rate and System Power Rate that are part of the Exchange Agreement's price term, and may lawfully include the System Access Rate in the wheeling rate, reversing the trial court decision on this issue. The Court held Metropolitan's allocation of the State Water Project 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., art. XIII C, §1, subd. (e)), Government Code section 54999.7, the common law, or the terms of the parties' Exchange Agreement.

The Court of Appeal also ruled that, based on the record, Metropolitan may not include its Water Stewardship Rate as a transportation cost in the Exchange Agreement price or the wheeling rate, under the wheeling statutes and the common law. Having made that determination, the Court of Appeal stated it need not evaluate the issue under any other law. 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 agreement. 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 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 July 6, 2017, SDCWA filed a petition for rehearing with the Court of Appeal. On July 18, 2017, the Court of Appeal modified the opinion to add one sentence, without a change in the judgment, and denied the petition. On July 31, 2017, SDCWA filed a petition for review with the California Supreme Court on the issue "Whether a state agency may charge its transportation-only customers costs associated with a service those customers do not purchase." Metropolitan filed its answer to SDCWA's petition on August 21, 2017. On September 27, 2017, the California Supreme Court denied SDCWA's petition, declining to consider the Court of Appeal's decision. The Court of Appeal's decision is therefore final. The 2010 and 2012 cases will now be returned to the trial court for a redetermination of damages, interest, and attorney's fees, including the question of whether there is a "prevailing party" entitled to fees, as ordered by the Court of Appeal. Metropolitan is unable to assess at this time the outcome of the matters to be redetermined by the trial court on remand. To the extent that the final court ruling invalidated portions of Metropolitan's adopted rates, Metropolitan will be obligated to reconsider and modify rates to comply with any final ruling related to Metropolitan's rates. While components of the rate structure and costs will change as a result of the ruling, Metropolitan expects that aggregate rates and charges would still recover Metropolitan's cost of service. As such, revenues would not be affected.

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 court ordered that the case be stayed. The stay may be lifted upon motion by any party. On November 20, 2015, SDCWA filed a motion to partially lift the stay. On December 21, 2015, the trial court denied that motion and the case remains 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 alleges 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 asserts misallocation of costs as alleged in the previous cases listed above and additional claims of over-collection and misallocation of costs and procedural violations. On June 30, 2016, the nine member agencies that are interested parties to the 2010, 2012, and 2014 cases filed answers to also join the 2016 case as interested parties in support of Metropolitan. On October 27, 2016, SDCWA filed a Motion for Leave to File Amended Complaint alleging the same Exchange Agreement breach alleged 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. The proposed amended petition/complaint also requests 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 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 November 10, 2016, pursuant to stipulation by the parties, the court ordered that the case be stayed pending final resolution of the appeals of the 2010 and 2012 SDCWA v. Metropolitan cases. Metropolitan is unable to assess at this time the likelihood of success of this case, any possible appeal or any future claims.

On June 9, 2017, SDCWA filed a new Petition for Writ of Mandate and Complaint challenging the Readiness-to-Serve (RTS) 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 alleges the 2018 RTS Charge and Capacity Charge violate the California Constitution, statutes, and common law. The petition/complaint asserts 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 the Metropolitan Board's action of July 11, 2017 to make minor corrections to the RTS Charge.

A number of other suits and claims arising in the normal course of business are pending against Metropolitan. In the opinion of Metropolitan's General Counsel, the adverse results, if any, of such legal actions on these suits and claims will not have a material effect on Metropolitan's financial position, changes in net position, or liquidity.

(i) 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 the Diemer, Jensen, Mills, Skinner and Weymouth plants with construction at the Weymouth plant completed in 2017.

(j) 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, the California Department of Water Resources (DWR) entered in to 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.

(k) 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. No expenses were incurred for postclosure maintenance and monitoring activities during the six months ended December 31, 2017 and 2016,

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 37 percent and 24 percent of Metropolitan's total expenses during the six months ended December 31, 2017 and 2016, respectively, pertained to its net payment obligations for the State Water Project. These costs 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.

Management's present intention is to exercise Metropolitan's option to extend the contractual period to at least 2052, under substantially comparable terms. This corresponds to an estimated 80-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 (see Note 6f).

Metropolitan capitalizes its share of system construction costs as participation rights when such costs are billed by the State (see Notes 1h, 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 information provided by the State of California. In fiscal year 2006, the formula was modified to use maximum annual contracted deliveries as the production capacity estimate. Amortization expense totaled $63.7 million and $65.1 million for the six months ended December 31, 2017 and 2016, respectively.

8. DEPOSITS, PREPAID COSTS, AND OTHER

Balances at December 31, 2017 and 2016 were as follows:

(Dollars in thousands)	December 31, 2017	2016
Prepaid water costs	**$ 159,371**	$ 116,215
Prepaid costs-Delta Habitat conservation and conveyance	**58,627**	58,627
Prepaid costs-Bay/Delta	—	2,252
Prepaid expenses	**6,449**	7,606
Preliminary design/reimbursable projects	**14,513**	10,918
Other	**69,102**	72,055
Total deposits, prepaid costs, and other	**308,062**	267,673
Less current portion	**(66,143)**	(70,034)
Noncurrent portion	**$ 241,919**	$ 197,639

(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 State Water Project 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 December 31, 2017 and 2016, prepaid water costs totaled approximately $159.4 million and $116.2 million, respectively, based on volumes of 871,000 acre-feet and 465,000 acre-feet, as of such dates.

(b) Prepaid Costs—Delta Habitat Conservation and Conveyance

In March 2009, Metropolitan, other State Water Project contractors, federal Central Valley Project contractors, and the U.S. Department of Interior's Bureau of Reclamation entered into funding agreements with the California Department of Water Resources (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 (refer to Paragraph 6.b) through environmental analysis, planning and design of Delta conservation measures including Delta water conveyance options. If the California WaterFix is approved, including construction of new Delta water conveyance facilities, DWR intends to issue revenue bonds in an amount sufficient to reimburse Metropolitan for funds advanced through these agreements for planning and environmental studies. If the California WaterFix is not approved to proceed with construction, no reimbursement will occur.

(c) Prepaid Costs—Bay/Delta

In December 1994, representatives from state and federal resource agencies, and urban, agricultural, and environmental agencies agreed to a set of principles to implement a protection plan for the San Francisco Bay/Delta Estuary. Among the principles was a commitment by agricultural and urban water agencies to fund $60.0 million to help initiate a comprehensive program to address non-outflow-related impacts to the Bay/Delta environment. The Secretary of the Interior requested Metropolitan to guarantee $10.0 million annually for three years, for a total of $30.0 million, to be made available for the restoration fund created by the principles. Metropolitan's final payment of its $30.0 million commitment was made in June 1998. Metropolitan's contributions are accounted for as prepaid costs that are charged to expense based on expenses by the restoration fund. During fiscal year 2001, Metropolitan became trustee for the unspent funds. In July 2017, the $2.7 million remaining unspent fund was returned to Metropolitan and the project was closed out. The balance of the trust at December 31, 2016 was $2.3 million.

(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.

Investment of the funds is managed by a third-party administrator, accordingly, at December 31, 2017 and 2016, neither the plan assets nor the related liability were included in the accompanying basic financial statements.

The third-party administrator coordinates the investment of the deferred amounts in available investment vehicles per the instructions of each participant. Metropolitan's Treasurer serves as Trustee for the deferred compensation plan. Metropolitan is not liable to its employees for any losses that may be incurred in connection with their participation in this plan.

Metropolitan has established another compensation deferral arrangement in accordance with Section 401(k) of the Internal Revenue Code. The 401(k) Consolidated Savings Plan is available to substantially all employees. Amounts deferred by participants, Metropolitan matching contributions, and accumulated earnings thereon are fully vested. Deferred amounts and matching contributions 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. The Treasurer serves as Trustee for the savings plan. Metropolitan is not liable to its employees for any losses that may be incurred in connection with their participation in this plan.

Metropolitan has established a matching contribution program on behalf of each participating employee in the savings plan. Metropolitan's contribution is subject to a maximum of 4.5 percent of the employee's total cash compensation.

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 related deferred outflows and inflows of resources related to debt. Metropolitan's capital assets, including State Water Project costs include plant and equipment (Note 1g), participation rights in State Water Project (Notes 1h and 7), and participation rights in other facilities. Net investment in capital assets, including State Water Project costs were approximately $6.1 billion and $6.0 billion at December 31, 2017 and 2016, respectively.

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 $402.1 million and $331.1 million at December 31, 2017 and 2016, respectively, of which $219.0 million and $147.9 million, respectively, represents principal and interest set aside for the next bond payment. The remaining $183.1 million and $183.2 million, respectively, relate to estimated operating and maintenance expense for January and February of the subsequent fiscal quarter. Each of these requirements is 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 $471.2 million and $532.8 million at December 31, 2017 and 2016, 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 and $5.0 million for workers' compensation. Metropolitan supplements its self-insurance program with $75.0 million excess general liability coverage and $50.0 million excess workers' compensation insurance. Metropolitan also carries coverage limits of $60.0 million for fiduciary liability and $65.0 million for directors' and officers' liability. Special insurance policies purchased 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 2018 were unchanged from fiscal year 2017. 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 (IBNR). 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% annual interest rate over the life of the claims.