



HETCH HETCHY WATER AND POWER

Financial Statements

June 30, 2012 and 2011

(With Independent Auditors' Report Thereon)

HETCH HETCHY WATER AND POWER

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KPMG LLP
Suite 1400
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San Francisco, CA 94105

Independent Auditors' Report

The Honorable Mayor and Board of Supervisors
City and County of San Francisco:

We have audited the accompanying financial statements of the business-type activities and each major fund of the Hetch Hetchy Water and Power (Hetch Hetchy), an enterprise of the City and County of San Francisco, California, (the City), as of and for the years ended June 30, 2012 and 2011 which collectively comprise the Hetch Hetchy's basic financial statements as listed in the table of contents. These financial statements are the responsibility of Hetch Hetchy's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Hetch Hetchy's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in note 1, the financial statements of Hetch Hetchy are intended to present the financial position, and the changes in financial position and cash flows of only that portion of the City that is attributable to the transactions of Hetch Hetchy. They do not purport to, and do not, present fairly the financial position of the City as of June 30, 2012 and 2011, the changes in its financial position, or, where applicable, the cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities and each major fund of Hetch Hetchy Water and Power as of June 30, 2012 and 2011, and the respective changes in financial position and cash flows thereof for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 25, 2012, on our consideration of the Hetch Hetchy's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.



U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 3 through 26 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

KPMG LLP

October 25, 2012

HETCH HETCHY WATER AND POWER

Management's Discussion and Analysis

June 30, 2012 and 2011

(Dollars in thousands, unless otherwise stated)

This section presents management's analysis of the San Francisco Hetch Hetchy Water and Power's (Hetch Hetchy) financial condition and activities as of and for the years ended June 30, 2012 and 2011. Management's Discussion and Analysis (MDA) is intended to serve as an introduction to Hetch Hetchy's financial statements. This information should be read in conjunction with the audited financial statements that follow this section. All dollar amounts, unless otherwise noted, are expressed in thousands of dollars.

The information in this MDA is presented under the following headings:

- Organization and Business
- Overview of the Financial Statements
- Financial Analysis
- Capital Assets and Debt Administration
- Next Year's Rates
- Request for Information

Organization and Business

The San Francisco Public Utilities Commission (SFPUC or the Commission) is an agency of the City and County of San Francisco (the City) that is responsible for the maintenance, operation, and development of three utility enterprises: Water, Wastewater, and Hetch Hetchy Water and Power (Hetch Hetchy). Hetch Hetchy was established as a result of the Raker Act of 1913, which granted water and power resource rights-of-way on the Tuolumne River in Yosemite National Park and the Stanislaus National Forest to the City. Hetch Hetchy operates the Hetch Hetchy Project that provides both electricity generation and up-country water service. Hetch Hetchy is engaged in the collection and conveyance of approximately 85% of the City's water supply and in the generation and transmission of electricity from that resource.

Approximately 68% of the electricity generated by Hetch Hetchy Power is used to provide electric service to the City's municipal customers (including the San Francisco Municipal Transportation Agency, Recreation and Parks Department, the Port of San Francisco, the San Francisco International Airport and its tenants, San Francisco General Hospital, street lights, Moscone Convention Center, and the Water and Wastewater Enterprises). The majority of the remaining 32% of electricity generated is sold to other publicly owned utilities, such as the Turlock and Modesto Irrigation Districts. Hetch Hetchy includes a system of reservoirs, hydroelectric power plants, aqueducts, pipelines, and transmission lines, carrying water over 170 miles and power more than 160 miles from the Sierra Nevada Mountain Range to customers in the City and portions of the surrounding San Francisco Bay Area.

Hetch Hetchy Water and Power

Hetch Hetchy Water and Power provides reliable, high quality water and electric energy to the City and other customers, protects watershed resources in cooperation with Federal agencies, operates and maintains facilities to a high standard of safety and reliability, and maximizes revenue opportunities within approved levels of risk.

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Hetch Hetchy Water and Power also strives to promote diversity and the health, safety and professional development of its employees.

Eighty-five percent of San Francisco's drinking water starts out as snow falling on 459 square miles of watershed land in Yosemite National Park and the City may supplement water supply from an additional 191 square miles of watershed in the Stanislaus National Forest during extremely dry years. As the snow melts, it collects in Hetch Hetchy's three storage reservoirs. As water flows by gravity through 170 miles of pipelines and tunnels, it turns the turbines in four hydroelectric powerhouses, generating approximately 1.9 billion kilowatt hours (kWh) of electricity per year. In fiscal year 2012, hydrogeneration reduced to approximately 1.3 billion kWh of electricity due to a planned maintenance system shutdown during December 2011 and January 2012. Over 160 miles of transmission and distribution lines move the electricity from the up-country powerhouses to the San Francisco Bay Area. The majority of the power is used for the City and County of San Francisco offices and services. Surplus power is sold to Central Valley irrigation districts (Turlock and Modesto) and other public agencies.

Hetch Hetchy Water and Power is comprised of two component funds: 1) Hetch Hetchy Water up-country operations and water system; and 2) Hetch Hetchy Power, also referred to as the Power Enterprise, which is wholly contained within Hetch Hetchy. A number of the facilities are joint assets and used for both water and power generation.

Hetch Hetchy Water

Hetch Hetchy Water operates as an effective, reliable water and power supplier, while managing resources in an environmentally sound manner. Hetch Hetchy Water is responsible for the operation, maintenance and improvement of its water and power facilities to a high standard of safety and reliability while meeting regulatory requirements. Hetch Hetchy Water distributes high quality water to SFPUC customers while optimizing generation of clean hydropower from the hydropower facilities. It maintains land and properties consistent with public health and neighborhood concerns.

Hetch Hetchy Power

The core business of Hetch Hetchy Power, as a municipal agency, is to provide adequate and reliable supplies of electric power to meet the electricity needs of the City's customers and to satisfy the municipal loads and agricultural pumping demands of the Modesto and Turlock Irrigation Districts consistent with prescribed contractual obligations and Federal law.

Hetch Hetchy Power's portfolio consists of hydroelectric generation, small on-site solar and third party purchases. Consistent with its commitment to the development of cleaner and greener power, and to address environmental concerns and community objectives, Hetch Hetchy Power continues to evaluate and expand its existing resource base to include additional renewables, distributed generation, demand management and energy efficiency programs.

As part of its mission and core functions, Hetch Hetchy Power aims to provide reliable energy services at reasonable cost to customers, with attention to environmental sustainability and community concerns.

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Hetch Hetchy Joint Water and Power

A portion of Hetch Hetchy provides benefit to both Hetch Hetchy Power and Hetch Hetchy Water. Both operating and capital costs that jointly benefit both funds are allocated 55% to Hetch Hetchy Power and 45% to Hetch Hetchy Water, as has historically been done by the SFPUC.

Overview of the Financial Statements

Hetch Hetchy's financial statements include:

Statements of Net Assets present information on Hetch Hetchy's assets and liabilities as of year-end, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of Hetch Hetchy is improving or deteriorating.

While the *Statements of Net Assets* provide information about the nature and amount of resources and obligations at year-end, the *Statements of Revenues, Expenses, and Changes in Net Assets* present the results of Hetch Hetchy's operations over the course of the fiscal year and information as to how the net assets changed during the year. These statements can be used as an indicator of the extent to which Hetch Hetchy has successfully recovered its costs through user fees and other charges. All changes in net assets are reported during the period in which the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. Thus, revenues and expenses are reported in these statements from some items that will result in cash flows in future fiscal periods, such as delayed collection of operating revenues and the expense of employee earned but unused vacation leave.

The *Statements of Cash Flows* present changes in cash and cash equivalents resulting from operational, capital, noncapital, and investing activities. These statements summarize the annual flow of cash receipts and cash payments, without consideration of the timing of the event giving rise to the obligation or receipt and exclude noncash accounting measures of depreciation or amortization of assets.

The *Notes to Financial Statements* provide information that is essential to a full understanding of the financial statements that is not presented on the face of the financial statements.

Financial Analysis

Financial Highlights for Fiscal Year 2012

Hetch Hetchy Water and Power

- Total assets of Hetch Hetchy exceeded total liabilities by \$512,652. Net assets increased by \$16,744 or 3.4% during the fiscal year. Capital assets, net of accumulated depreciation, increased by \$31,977 or 10.5% to \$335,395.
- Charges for services, excluding interest and investment income, rental income and other non-operating revenues, decreased by \$12,714 or 9.1% to \$127,066. Operating expenses, excluding interest expenses and other non-operating expenses, increased by \$11,890 or 10.0% to \$130,610.

HETCH HETCHY WATER AND POWER

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(Dollars in thousands, unless otherwise stated)

Hetch Hetchy Water

- Total assets of Hetch Hetchy Water exceeded total liabilities by \$136,522. Net assets increased by \$10,428 or 8.3% during the fiscal year. Capital assets, net of accumulated depreciation, increased by \$2,433 or 2.8% to \$87,941.
- Charges for services representing water sales, which exclude interest and investment income, rental income and other non-operating revenues, increased by \$1,060 or 3.4% to \$32,386 due to increase of water assessment fees from Water Enterprise. Operating expenses increased by \$4,524 or 13.9% to \$37,003 primarily due to increases of \$1,879 in general and administrative expenses for taxes, licenses, and permits, \$1,529 in personal services for increased salaries, retirement, health care benefits and workers' compensation costs, \$1,338 in non-capitalized project expenses, and \$139 in materials and supplies. These increases were offset by decreases of \$277 in services provided by other departments for legal and risk management services, \$66 in depreciation, and \$18 in contractual services.

Hetch Hetchy Power

- Total assets of Hetch Hetchy Power exceeded total liabilities by \$376,130. Net assets increased by \$6,316 or 1.7% during the fiscal year. Capital assets, net of accumulated depreciation, increased by \$29,544 or 13.6% to \$247,454.
- Charges for services representing electricity sales, which exclude interest and investment income, rental income and other non-operating revenues, decreased by \$13,774 or 12.7% to \$94,680 mainly due to lower electricity generation and sales to other municipalities and governmental agencies under Western System Power Pool (WSPP) and Treasure Island Development Authority (TIDA). Operating expenses increased by \$7,366 or 8.5% to \$93,607 mainly due to \$3,521 in purchased electricity resulting from a three-month shut-down for maintenance at the Moccasin generation facility, \$3,245 in salaries, retirement, health care and other fringe benefits, and \$2,072 in non-capitalized project expenses, \$676 in services provided by other departments for environmental, risk management, and legal services, \$214 in depreciation, \$170 in general and administrative, and \$56 in materials and supplies. These increases were offset by decreases of \$1,337 in contractual services and \$1,251 in transmission and distribution power costs.

Financial Highlights for Fiscal Year 2011

Hetch Hetchy Water and Power

- Total assets of Hetch Hetchy exceeded total liabilities by \$495,908. Net assets increased by \$39,538 or 8.7% during the fiscal year. Capital assets, net of accumulated depreciation, increased by \$17,648 or 6.2% to \$303,418.
- Charges for services, excluding interest and investment income, rental income and other non-operating revenues, increased by \$11,435 or 8.9% to \$139,780. Operating expenses, excluding interest expenses and other non-operating expenses, increased by \$333 or 0.3% to \$118,720. In the prior year, operating expenses increased by \$22,159 largely due to higher non-capitalized project expenses, capital project write-offs, and a one-time \$10,194 of combustion turbine asset write-off as a result of settlement.

HETCH HETCHY WATER AND POWER

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(Dollars in thousands, unless otherwise stated)

Hetch Hetchy Water

- Total assets of Hetch Hetchy Water exceeded total liabilities by \$126,094. Net assets increased by \$12,945 or 11.4% during the fiscal year. Capital assets, net of accumulated depreciation, decreased by \$1,126 or 1.3% to \$85,508.
- Charges for services representing water sales, which exclude interest and investment income, rental income and other nonoperating revenues, increased by \$217 or 0.7% to \$31,326. Operating expenses increased by \$426 or 1.3% to \$32,479 due to increases of \$557 in personal services, \$294 in services provided by other departments for risk management and legal services, \$99 in materials and supplies, and \$33 in depreciation, offset by decreases of \$349 contractual services and \$208 in noncapitalized project expenditures.

Hetch Hetchy Power

- Total assets of Hetch Hetchy Power exceeded total liabilities by \$369,814. Net assets increased by \$26,593 or 7.8% during the fiscal year. Capital assets, net of accumulated depreciation, increased by \$18,774 or 9.4% to \$217,910.
- Charges for services representing electricity sales, which exclude interest and investment income, rental income and other nonoperating revenues, increased by \$11,218 or 11.5% to \$108,454 mainly due to higher electricity generation and sales to other municipalities and governmental agencies under Western System Power Pool (WSPP), Treasure Island Development Authority (TIDA), as well as City departments. Operating expenses, which exclude other nonoperating expenses, decreased by \$93 or 0.1% to \$86,241.

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(Dollars in thousands, unless otherwise stated)

Financial Position

The following tables summarize Hetch Hetchy's changes in net assets.

Table 1A: Consolidated Hetch Hetchy Water and Power Comparative Condensed Net Assets

Table 1A – Consolidated Hetch Hetchy Water and Power Comparative Condensed Net Assets

June 30, 2012, 2011 and 2010

	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2012-2011 Change</u>	<u>2011-2010 Change</u>
Current and other assets	\$ 260,584	254,380	232,470	6,204	21,910
Capital assets, net of accumulated depreciation	<u>335,395</u>	<u>303,418</u>	<u>285,770</u>	<u>31,977</u>	<u>17,648</u>
Total assets	<u>595,979</u>	<u>557,798</u>	<u>518,240</u>	<u>38,181</u>	<u>39,558</u>
Current liabilities	27,835	23,669	27,975	4,166	(4,306)
Long-term liabilities	<u>55,492</u>	<u>38,221</u>	<u>33,895</u>	<u>17,271</u>	<u>4,326</u>
Total liabilities	<u>83,327</u>	<u>61,890</u>	<u>61,870</u>	<u>21,437</u>	<u>20</u>
Net assets:					
Invested in capital assets, net of related debt	309,640	293,600	282,698	16,040	10,902
Restricted for capital projects	14,282	—	—	14,282	—
Unrestricted	<u>188,730</u>	<u>202,308</u>	<u>173,672</u>	<u>(13,578)</u>	<u>28,636</u>
Total net assets	<u>\$ 512,652</u>	<u>495,908</u>	<u>456,370</u>	<u>16,744</u>	<u>39,538</u>

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Table 1B: Hetch Hetchy Water Comparative Condensed Net Assets

Table 1B – Hetch Hetchy Water Comparative Condensed Net Assets

June 30, 2012, 2011 and 2010

	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2012-2011 Change</u>	<u>2011-2010 Change</u>
Current and other assets	\$ 59,285	49,370	34,512	9,915	14,858
Capital assets, net of accumulated depreciation	<u>87,941</u>	<u>85,508</u>	<u>86,634</u>	<u>2,433</u>	<u>(1,126)</u>
Total assets	<u>147,226</u>	<u>134,878</u>	<u>121,146</u>	<u>12,348</u>	<u>13,732</u>
Current liabilities	3,369	2,926	4,696	443	(1,770)
Long-term liabilities	<u>7,335</u>	<u>5,858</u>	<u>3,301</u>	<u>1,477</u>	<u>2,557</u>
Total liabilities	<u>10,704</u>	<u>8,784</u>	<u>7,997</u>	<u>1,920</u>	<u>787</u>
Net assets:					
Invested in capital assets, net of related debt	87,941	85,508	86,634	2,433	(1,126)
Restricted for capital projects	14,170	—	—	14,170	—
Unrestricted	<u>34,411</u>	<u>40,586</u>	<u>26,515</u>	<u>(6,175)</u>	<u>14,071</u>
Total net assets	<u>\$ 136,522</u>	<u>126,094</u>	<u>113,149</u>	<u>10,428</u>	<u>12,945</u>

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(Dollars in thousands, unless otherwise stated)

Table 1C: Hetch Hetchy Power Comparative Condensed Net Assets

Table 1C - Hetch Hetchy Power Comparative Condensed Net Assets

June 30, 2012, 2011 and 2010

	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2012-2011 Change</u>	<u>2011-2010 Change</u>
Current and other assets	\$ 201,299	205,010	197,958	(3,711)	7,052
Capital assets, net of accumulated depreciation	<u>247,454</u>	<u>217,910</u>	<u>199,136</u>	<u>29,544</u>	<u>18,774</u>
Total assets	<u>448,753</u>	<u>422,920</u>	<u>397,094</u>	<u>25,833</u>	<u>25,826</u>
Current liabilities	24,466	20,743	23,279	3,723	(2,536)
Long-term liabilities	<u>48,157</u>	<u>32,363</u>	<u>30,594</u>	<u>15,794</u>	<u>1,769</u>
Total liabilities	<u>72,623</u>	<u>53,106</u>	<u>53,873</u>	<u>19,517</u>	<u>(767)</u>
Net assets:					
Invested in capital assets, net of related debt	221,699	208,092	196,064	13,607	12,028
Restricted for capital projects	112	—	—	112	—
Unrestricted	<u>154,319</u>	<u>161,722</u>	<u>147,157</u>	<u>(7,403)</u>	<u>14,565</u>
Total net assets	<u>\$ 376,130</u>	<u>369,814</u>	<u>343,221</u>	<u>6,316</u>	<u>26,593</u>

Net Assets, Fiscal Year 2012

Hetch Hetchy Water and Power

Hetch Hetchy's net assets of \$512,652 increased by \$16,744 or 3.4% during the year (see Table 1A). Current and other assets were \$260,584, a \$6,204 or 2.4% increase from prior year primarily due to increases of \$21,479 in restricted cash and investments with City Treasury consisting of \$14,880 for the Water Enterprise transfer to finance improvements of certain up-country water storage and transmission facilities and \$6,599 from the issuance of the New Clean Renewable Energy Bonds (NCREBs). Other increases included \$4,664 in cash from operating revenues, \$1,678 in claims receivable and deferred charges for the Civic Center Garage lease prepayment, \$361 in interest receivables, and \$133 in bond issuance costs. These increases were offset by a decrease of \$10,212 primarily due from City departments and the Water Enterprise cash transfer of \$13,638, net of an increase of \$4,619 in receivables from the Water and Wastewater Enterprises for their share of 525 Golden Gate Headquarters project costs including information technology equipment and the living machine system. Other decreases included \$8,940 in cash and investments outside City Treasury for reimbursements to 525 Golden Gate Headquarters project costs, \$2,176 in receivables from charges for services, \$574 in Department of Energy grant receivable, \$179 in other receivables, and \$30 in inventories.

Capital assets, net of accumulated depreciation, increased by \$31,977 to \$335,395. Total liabilities were \$83,327, an increase of \$21,437 or 34.6%, which is attributed to increases from \$14,693 issuance of long-term debt, and net of amortization of premium from the certificates of participation, \$5,999 in accounts payable for increased

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construction activity, \$3,081 in other post-employment benefits obligation based on higher annual required contribution, \$541 in accrued payroll liability, \$541 in damage claims liability based on estimate, \$494 in accrued vacation and sick leave, \$258 in workers' compensation liability and \$163 in restricted liabilities related to debt funded projects. These liability increases were offset by decreases of \$3,036 in inter-fund payable to the Water Enterprise for the 525 Golden Gate Headquarters project costs, \$989 in deferred credits for Pacific Gas & Electric Company (PG&E) settlement refunds, and \$308 in pollution remediation liability. Hetch Hetchy's net assets of investment in capital assets, net of related debt, increased by \$16,040 or 5.5% over the prior year to \$309,640. Restricted assets for capital projects of \$14,170 were transfers (net of expenditures) from the Water Enterprise for bond funded Hetch Hetchy Water facility improvements.

Hetch Hetchy Water

Hetch Hetchy Water's net assets of \$136,522 increased by \$10,428 or 8.3% resulting from increases in total assets of \$12,348 and total liabilities of \$1,920 (see Table 1B). Contributing to the increase of \$12,348 in total assets were increases of \$14,880 of Water Enterprise cash transfer restricted for the purpose of financing improvements of up-country water storage and transmission facilities, \$8,759 in cash from operations, \$2,433 in capital assets, net of accumulated depreciation, \$75 in interest receivables from pooled cash investment, \$13 in restricted interest receivables, and \$10 in damage claims receivable. These increases were offset by decreases of \$13,638 in cash transfer from Water Enterprise, \$170 in receivables from charges for services, and \$14 in inventories. The increase in total liabilities of \$1,920 was due to increases of \$1,386 in other post-employment benefits obligation for higher annual required contribution, \$723 in accrued restricted liabilities related to projects funded with Water Enterprise bonds, \$227 in damage claims liability based on estimate, \$222 in accrued vacation and sick leave, \$139 in payroll liability, \$116 in workers' compensation liability offset by decreases of \$567 in accounts payable, \$308 in pollution remediation liability, and \$18 in deferred credits for property rental payments. Hetch Hetchy Water's investment in capital assets, net of related debt, was \$87,941 or 64.4% of Hetchy Hetchy's water total net assets. Restricted assets for capital projects of \$14,170 were transfers (net of expenditures) from the Water Enterprise for bond funded Hetch Hetchy Water facility improvements.

Hetch Hetchy Power

Hetch Hetchy Power's net assets of \$376,130 increased by \$6,316 or 1.7% resulting from increases in total assets of \$25,833 and total liabilities of \$19,517 (see Table 1C). Hetch Hetchy Power's total asset increase of \$25,833 mainly due to increases of \$29,544 in capital assets, net of accumulated depreciation, and \$6,599 from the issuance of the New Clean Renewable Energy Bonds (NCREBs), in restricted cash and investment with City Treasury for bond funded projects, \$3,426 due from Water and Wastewater Enterprises for their share of the 525 Golden Gate Headquarters project costs, \$1,668 in deferred charges for Civic Center Garage lease prepayment, \$273 in interest receivables, and \$133 in unamortized bond issuance costs. These increases were offset by decreases of \$8,940 in restricted cash and investments outside City Treasury due to lower reimbursements for 525 Golden Gate Headquarters project costs, \$4,095 in cash from operations, \$2,029 decreased receivables from service charges, \$574 in Department of Energy federal grant receivable due to reimbursement, \$156 in other receivables and \$16 in inventories. Increase in Hetch Hetchy's Power liabilities of \$19,517 was mainly due to issuance of \$8,291 Qualified Energy Conservation Bonds (QECBs), \$6,600 New Clean Renewable Energy Bonds (NCREBs), \$6,566 in accounts payable for increased construction activity, \$1,695 in other post-employment benefits obligation for higher annual required contribution, \$402 in accrued payroll liability, \$314 in damage claims liability based on estimate, \$272 in accrued vacation and sick leave, \$265 in bond interest

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payable, \$142 in workers' compensation liability, and \$13 in bond discount amortization. These liability increases were offset by decreases of \$3,036 in payable to the Water Enterprise for 525 Golden Gate Headquarters project costs, \$971 in deferred credits relating to PG&E settlement refunds, \$560 in accrued restricted liabilities related to projects funded with Water Enterprise bonds, \$422 of payment for Clean Renewable Energy bonds, and \$54 in bond premium amortization. Hetch Hetchy Power's investment in capital assets, net of related debt, was \$221,699 or 58.9% of total net assets.

Net Assets, Fiscal Year 2011

Hetch Hetchy Water and Power

Hetch Hetchy's net assets of \$495,908 increased by \$39,538 or 8.7% during the year (see Table 1A). Current and other assets were \$254,380, a \$21,910 or 9.4% increase from prior year primarily due to an increase of \$21,135 in cash from increased operating revenues and \$13,638 in receivables from the Water Enterprise for bond-funded facility improvements. The increases were offset by decreases of \$6,525 in cash and investments outside City Treasury primarily for reimbursements to 525 Golden Gate Avenue Headquarters project expenses, and \$6,338 in receivables mainly reflecting Combustion Turbine settlement close-out proceeds. Total liabilities were \$61,890, slightly increased from prior year. Hetch Hetchy's net assets of investment in capital assets, net of related debt, increased by \$10,902 or 3.9% over the prior year to \$293,600.

Hetch Hetchy Water

Hetch Hetchy Water's net assets of \$126,094 increased by \$12,945 or 11.4% resulting from increases in total assets of \$13,732 and total liabilities of \$787 (see Table 1B). Contributing to the increase of \$13,732 in total assets were increases of \$13,638 in receivables from the Water Enterprise for bond-funded facility improvements, \$1,142 in unrestricted cash and investments due to increased operating revenues and decreased capital project spending, as well as \$78 in receivables and inventories, offset by a decrease of \$1,126 in capital assets, net of accumulated depreciation. The increase in total liabilities of \$787 was mainly due to increases of \$1,340 in pollution remediation related to the Mitchell Ravine project, \$1,238 in other post-employment benefits obligation based on higher annual required contribution, \$21 in deposits, and \$12 in payroll related liabilities. These increases were offset by decreases of \$1,783 in accounts payable due to higher payments made during the fiscal year, \$39 in damage claims liability based on actuarial estimate, and \$2 in workers' compensation liability. Hetch Hetchy Water's investment in capital assets, net of related debt, was \$85,508 or 67.8% of the total net assets.

Hetch Hetchy Power

Hetch Hetchy Power's net assets of \$369,814 increased by \$26,593 or 7.8% due to an increase of \$25,826 in total assets, and a decrease of \$767 in total liabilities (see Table 1C). Hetch Hetchy Power's total asset increase of \$25,826 was primarily due to increases of \$19,993 in unrestricted cash from operating revenues, \$18,774 in capital assets, net of accumulated depreciation, and \$620 in deferred charges and inventory. These increases were offset by decreases of \$6,525 in restricted cash and investments outside City Treasury as reimbursement of funds to 525 Golden Gate Avenue Headquarters project costs, \$6,377 in receivables mainly reflecting Combustion Turbine settlement close-out proceeds, and \$659 in due from other City department receivables. Decreases of \$767 in Hetch Hetchy Power's total liabilities were due to decreases of \$1,841 in accounts payable, \$1,310 due to the Water Enterprise for the 525 Golden Gate Headquarters project expenses, \$459 resulting from \$422

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payment for Clean Renewable Energy Bonds (CREBs) and amortization of bond discounts and certificates of participation premiums, as well as \$3 in workers' compensation liability. These decreases were offset by increases of \$1,511 in other post-employment benefits obligation based on higher annual required contribution, \$669 in accrued restricted liabilities related to projects funded by CREBs, \$298 in damage claims liability based on actuarial estimate, \$191 in deposits of custom work and refunds payable of energy taxes and deferred interest, \$166 in accrued payroll, and \$11 in accrued vacation and sick leave. Hetch Hetchy Power's investment in capital assets, net of related debt, was \$208,092 or 56.3% of the total net assets.

Results of Operations

The following tables summarize Hetch Hetchy's revenues, expenses, and changes in net assets:

Table 2A: Consolidated Hetch Hetchy Water and Power Revenues, Expenses, and Changes in Net Assets

**Table 2A – Consolidated Hetch Hetchy Water and Power
Comparative Condensed Revenues, Expenses, and Changes in Net Assets**

Years ended June 30, 2012, 2011 and 2010

	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2012-2011 Change</u>	<u>2011-2010 Change</u>
Revenues:					
Charges for services	\$ 127,066	139,780	128,345	(12,714)	11,435
Rents and concessions	243	255	245	(12)	10
Interest and investment income	3,463	2,185	2,738	1,278	(553)
Other non-operating revenues	5,857	7,617	6,495	(1,760)	1,122
Total revenues	<u>136,629</u>	<u>149,837</u>	<u>137,823</u>	<u>(13,208)</u>	<u>12,014</u>
Expenses:					
Operating expenses	130,610	118,720	118,387	11,890	333
Other non-operating expenses	3,346	5,033	6,043	(1,687)	(1,010)
Total expenses	<u>133,956</u>	<u>123,753</u>	<u>124,430</u>	<u>10,203</u>	<u>(677)</u>
Income before transfers	2,673	26,084	13,393	(23,411)	12,691
Transfers in (out)	14,071	13,454	(1,400)	617	14,854
Changes in net assets	16,744	39,538	11,993	(22,794)	27,545
Net assets at beginning of year	<u>495,908</u>	<u>456,370</u>	<u>444,377</u>	<u>39,538</u>	<u>11,993</u>
Net assets at end of year	<u>\$ 512,652</u>	<u>495,908</u>	<u>456,370</u>	<u>16,744</u>	<u>39,538</u>

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Table 2B: Hetch Hetchy Water Revenues, Expenses, and Changes in Net Assets

**Table 2B – Hetch Hetchy Water
Comparative Condensed Revenues, Expenses, and Changes in Net Assets**

Years ended June 30, 2012, 2011 and 2010

	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2012-2011 Change</u>	<u>2011-2010 Change</u>
Revenues:					
Charges for services	\$ 32,386	31,326	31,109	1,060	217
Rents and concessions	109	115	110	(6)	5
Interest and investment income	874	220	657	654	(437)
Other non-operating revenues	57	193	39	(136)	154
Total revenues	<u>33,426</u>	<u>31,854</u>	<u>31,915</u>	<u>1,572</u>	<u>(61)</u>
Expenses:					
Operating expenses	37,003	32,479	32,053	4,524	426
Other non-operating expenses	68	68	—	—	68
Total expenses	<u>37,071</u>	<u>32,547</u>	<u>32,053</u>	<u>4,524</u>	<u>494</u>
Loss before transfers	(3,645)	(693)	(138)	(2,952)	(555)
Transfers in	14,073	13,638	—	435	13,638
Changes in net assets	10,428	12,945	(138)	(2,517)	13,083
Net assets at beginning of year	<u>126,094</u>	<u>113,149</u>	<u>113,287</u>	<u>12,945</u>	<u>(138)</u>
Net assets at end of year	<u>\$ 136,522</u>	<u>126,094</u>	<u>113,149</u>	<u>10,428</u>	<u>12,945</u>

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Table 2C: Hetch Hetchy Power Revenues, Expenses, and Changes in Net Assets

**Table 2C – Hetch Hetchy Power
Comparative Condensed Revenues, Expenses, and Changes in Net Assets**

Years ended June 30, 2012, 2011 and 2010

	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2012-2011 Change</u>	<u>2011-2010 Change</u>
Revenues:					
Charges for services	\$ 94,680	108,454	97,236	(13,774)	11,218
Rents and concessions	134	140	135	(6)	5
Interest and investment income	2,589	1,965	2,081	624	(116)
Other non-operating revenues	5,800	7,424	6,456	(1,624)	968
Total revenues	<u>103,203</u>	<u>117,983</u>	<u>105,908</u>	<u>(14,780)</u>	<u>12,075</u>
Expenses:					
Operating expenses	93,607	86,241	86,334	7,366	(93)
Other non-operating expenses	3,278	4,965	6,043	(1,687)	(1,078)
Total expenses	<u>96,885</u>	<u>91,206</u>	<u>92,377</u>	<u>5,679</u>	<u>(1,171)</u>
Income before transfers	6,318	26,777	13,531	(20,459)	13,246
Transfers out	(2)	(184)	(1,400)	182	1,216
Changes in net assets	6,316	26,593	12,131	(20,277)	14,462
Net assets at beginning of year	<u>369,814</u>	<u>343,221</u>	<u>331,090</u>	<u>26,593</u>	<u>12,131</u>
Net assets at end of year	<u>\$ 376,130</u>	<u>369,814</u>	<u>343,221</u>	<u>6,316</u>	<u>26,593</u>

Results of Operations, Fiscal Year 2012

Hetch Hetchy Water and Power

Hetch Hetchy's total revenues were \$136,629, a decrease of \$13,208 or 8.8% over the prior year (see Table 2A). Hetch Hetchy's total expenses were \$133,956, an increase of \$10,203 or 8.2% over the prior year.

Hetch Hetchy Water

Hetch Hetchy Water's total revenues were \$33,426, an increase of \$1,572 or 4.9% over the prior year (see Table 2B). The increase was due to \$1,060 in charges for services attributed to an increase in water assessment fee of \$892, and an increase of \$654 in interest and investment income, offset by decreases of \$136 in other non-operating revenues and \$6 in rent and concession. Total expenses were \$37,071, an increase of \$4,524 or 13.9% due to increases of \$1,879 in general and administrative expenses for taxes, licenses, and permits, \$1,529 in personal services for increased salaries, retirement, health care benefits and workers' compensation costs, \$1,338 in noncapitalized project expenses, and \$139 in materials and supplies. These increases were offset by decreases

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of \$277 in services provided by other departments for legal and risk management services, \$66 in depreciation, and \$18 in contractual services. The transfer of \$14,073 from the Water Enterprise is to finance improvements of certain up-country water storage and transmission facilities.

Hetch Hetchy Power

Hetch Hetchy Power's total revenues were \$103,203, a decrease of \$14,780 or 12.5% over the prior year (see Table 2C). Charges for services representing electricity sales, which excludes interest and investment income, rental income and other non-operating revenues, decreased by \$13,774 or 12.7% to \$94,680 mainly due to lower electricity generation and sales to other municipalities and governmental agencies under Western System Power Pool (WSPP) and Treasure Island Development Authority (TIDA). Other decreases included \$1,624 in other non-operating revenues primarily due to \$2,149 decreased in federal grants from Department of Energy offset by a \$525 settlement with PG&E for reimbursement of utility upgrades to facilities from prior year, and \$6 in rent and concessions, offset by an increase of \$624 in interest and investment income. Operating expenses increased by \$7,366 or 8.5% to \$93,607 mainly due to \$3,521 in purchased electricity resulting from a three-month shut-down for maintenance at the Moccasin generation facility, \$3,245 in salaries, retirement, health care and workers' compensation costs, and \$2,072 in noncapitalized project expenses, \$676 in services provided by other departments for environmental, risk management, and legal services, \$214 in depreciation, \$170 in general and administrative, and \$56 in materials and supplies. These increases were offset by decreases of \$1,337 in contractual services and \$1,251 in transmission and distribution power costs. Other nonoperating expenses decreased by \$1,687 or 34.0% to \$3,278 due to decreases of \$1,224 in solar incentive program costs, and \$463 in higher capitalized interest expense.

Results of Operations, Fiscal Year 2011

Hetch Hetchy Water and Power

Hetch Hetchy's total revenues were \$149,837, an increase of \$12,014 or 8.7% over the prior year (see Table 2A). Hetch Hetchy's total expenses were \$123,753, a decrease of \$677 or 0.5% over the prior year.

Hetch Hetchy Water

Hetch Hetchy Water's total revenues were \$31,854, a decrease of \$61 or 0.2% over the prior year (see Table 2B). In the prior year, total revenues increased by \$6,446 mainly due to an increase in the water assessment fee. There was no increase in water assessment fee in fiscal year 2011, offset slightly by average increase of 15% of upcountry retail water rates adjusted for water consumption. Total expenses were \$32,547, an increase of \$494 or 1.5% mainly due to increases of \$557 in personal services, \$294 in services provided by other departments for risk management and legal services, \$99 in materials and supplies, \$68 in other nonoperating expenses, and \$33 in depreciation, offset by decreases in noncapitalized project expenses of \$208 and \$349 in contractual services. The transfer of \$13,638 from the Water Enterprise was to finance improvements of certain up-country water storage and transmission facilities.

Hetch Hetchy Power

Hetch Hetchy Power's total revenues were \$117,983, an increase of \$12,075 or 11.4% over the prior year (see Table 2C). The majority of this revenue increase resulted from increased electricity sales of \$7,751 primarily due to the Western System Power Pool (WSPP). Additionally, Hetch Hetchy Power revenue increased by \$3,467

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related to higher sales to the Treasure Island Development Authority and City departments including the San Francisco International Airport, Port and Department of Public Works due to increased power usage and/or rate increases. Other nonoperating revenues increased by \$968 or 15.0%, which is primarily due to the receipt of additional \$4,533 in federal grants offset by the \$2,895 settlement with the State Department of Water Resources related to the Combustion Turbine project received in the prior year. Rental income increased by \$5. These increases were offset by decreases in interest and investment income of \$116. Hetch Hetchy Power's total expenses decreased by \$1,171 or 1.3%, mainly due to a reduction of \$9,015 in project write-offs primarily related to the Combustion Turbine project write-off in the prior year and noncapitalized project expenses, \$918 of solar incentive program expense, and \$160 in interest expense. These decreases are offset by increases of \$3,083 which included increases of \$3,049 in judgments and claims due to increases in actuarial estimates and \$34 of services of other departments, \$2,719 in salaries, retirement and health benefits, of which \$1,088 was a result of 9 positions converted from project-funded to operating fund and \$1,631 due to higher retirement contributions and workers' compensation costs, \$1,043 in depreciation, \$905 in purchased electricity costs, \$638 in transmission and distribution of power costs, \$436 in contractual services, and \$98 in materials and supplies.

Capital Assets and Debt Administration

Capital Assets

The following tables summarize Hetch Hetchy's changes in capital assets.

Table 3A: Consolidated Hetch Hetchy Water and Power Capital Assets

**Table 3A – Consolidated Hetch Hetchy Water and Power
Capital Assets, Net of Depreciation**

Years ended June 30, 2012, 2011 and 2010

	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2012-2011 Change</u>	<u>2011-2010 Change</u>
Facilities, improvements, machinery, and equipment	\$ 235,367	209,341	215,679	26,026	(6,338)
Land and rights-of-way	4,720	4,665	4,665	55	—
Intangible assets	29,169	29,652	30,001	(483)	(349)
Construction work in progress	66,139	59,760	35,425	6,379	24,335
Total	<u>\$ 335,395</u>	<u>303,418</u>	<u>285,770</u>	<u>31,977</u>	<u>17,648</u>

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Table 3B: Hetch Hetchy Water Capital Assets

**Table 3B – Hetch Hetchy Water
Capital Assets, Net of Depreciation**

Years ended June 30, 2012, 2011 and 2010

	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2012-2011 Change</u>	<u>2011-2010 Change</u>
Facilities, improvements, machinery, and equipment	\$ 58,247	58,424	62,429	(177)	(4,005)
Land and rights-of-way	3,028	3,003	3,003	25	—
Intangible assets	12,446	12,653	12,860	(207)	(207)
Construction work in progress	14,220	11,428	8,342	2,792	3,086
Total	<u>\$ 87,941</u>	<u>85,508</u>	<u>86,634</u>	<u>2,433</u>	<u>(1,126)</u>

Table 3C: Hetch Hetchy Power Capital Assets

**Table 3C – Hetch Hetchy Power
Capital Assets, Net of Depreciation**

Years ended June 30, 2012, 2011 and 2010

	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2012-2011 Change</u>	<u>2011-2010 Change</u>
Facilities, improvements, machinery, and equipment	\$ 177,120	150,917	153,250	26,203	(2,333)
Land and rights-of-way	1,692	1,662	1,662	30	—
Intangible assets	16,723	16,999	17,141	(276)	(142)
Construction work in progress	51,919	48,332	27,083	3,587	21,249
Total	<u>\$ 247,454</u>	<u>217,910</u>	<u>199,136</u>	<u>29,544</u>	<u>18,774</u>

Capital Assets, Fiscal Year 2012

Hetch Hetchy Water and Power

Hetch Hetchy has net capital assets of \$335,395 invested in both water and power utility capital assets as of June 30, 2012 (see Table 3A). This amount represents an increase of \$31,977 or 10.5%, resulting from an increase of \$26,026 in facilities, improvements, machinery and equipment, an increase of \$6,379 in construction work in progress, and an increase to land and rights-of-way of \$55 offset by a decrease of \$483 in intangible assets, net of depreciation.

With the adoption of GASB Statement 51, Hetch Hetchy reclassified water rights, easements, and emission reduction credits for a total of \$30,001 in intangible assets net of depreciation as of June 30, 2010. As of June 30, 2011, Hetch Hetchy intangible assets were \$12,653 and \$16,999 for Hetch Hetchy Water and Hetch Hetchy Power, respectively. Hetch Hetchy did not have any new additions to intangible assets as of June 30, 2012, and

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intangible asset balances net of depreciation were \$12,446 and \$16,723 for Hetch Hetchy Water and Hetch Hetchy Power, respectively.

The investment in capital assets includes land, buildings, improvements, hydropower facilities, dams, transmission lines, machinery, and equipment.

Major additions to construction work in progress during the year ended June 30, 2012 include:

**Table 3D – 1 Hetch Hetchy Water and Power
Major Additions to Construction Work in Progress**

Year ended June 30, 2012

	Hetch Hetchy Water	Hetch Hetchy Power	Total 2012 Hetch Hetchy Water & Power
525 Golden Gate Headquarters Project	\$ —	9,771	9,771
525 Golden Gate Energy Efficiency Project	—	6,915	6,915
Oil Containment Project	1,530	1,869	3,399
Exciters, Switchgear, Breakers, and Motor Control Centers	—	1,926	1,926
Generators	—	1,558	1,558
Western Electric Coordination Council Compliance Program	—	1,545	1,545
Small Water System Quality Improvements	666	814	1,480
Transformers Rehabilitation	—	1,293	1,293
Transmissions/Distributions System	—	1,252	1,252
Other project additions individually below \$1,200	4,486	12,652	17,138
	\$ 6,682	39,595	46,277

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Major depreciable facilities, improvements, intangible assets, machinery and equipment placed in service, including transfers of completed projects from construction work in progress, during the year ended June 30, 2012 include:

**Table 3D – 2 Hetch Hetchy Water and Power
Major Facilities, Improvements, Intangible Assets, Machinery and Equipment
Placed in Service**

Year ended June 30, 2012

	Hetch Hetchy Water	Hetch Hetchy Power	Total 2012 Hetch Hetchy Water & Power
525 Golden Gate Headquarters Project	\$ —	19,051	19,051
525 Golden Gate Headquarters Project HVAC	—	3,005	3,005
525 Golden Gate Headquarters Project Wind Power	—	1,854	1,854
525 Golden Gate Headquarters Project Solar Power Panels	—	1,753	1,753
Acoustic Fiber Optic Monitoring System	1,674	—	1,674
Solar Photovoltaic Renewable Energy Plant	—	1,489	1,489
525 Golden Gate Headquarters Project Solar Control	—	1,302	1,302
Other project additions individually below \$1,000	2,005	7,347	9,352
	\$ 3,679	35,801	39,480

Hetch Hetchy Water

Hetch Hetchy Water has net capital assets of \$87,941 invested in a broad range of utility capital assets as of June 30, 2012 (see Table 3B). This amount represents an increase of \$2,433 or 2.8%, primarily due to increases of \$2,792 in construction work in progress and an increase of \$25 in land and rights-of-way, offset by decreases of \$207 in intangible assets and \$177 in facilities, improvements, machinery and equipment.

With the adoption of GASB Statement 51, Hetch Hetchy Water reclassified \$12,860 of water rights and easements in intangible assets net of depreciation as of June 30, 2010. In fiscal year 2012 and 2011, total intangible assets net of depreciation were \$12,446 and \$12,653 for Hetch Hetchy Water, respectively.

For the year ended June 30, 2012, Hetch Hetchy Water's major additions to construction work in progress totaled \$6,682 (see Table 3D-1). Major depreciable facilities, improvements, intangible assets, machinery and equipment placed in service totaled \$3,679 (see Table 3D-2).

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Hetch Hetchy Power

Hetch Hetchy Power has net capital assets of \$247,454 invested in power utility capital assets as of June 30, 2012 (see Table 3C). This amount represents an increase of \$29,544 or 13.6%, primarily due to an increase of \$26,203 in facilities, improvements, machinery and equipment, an increase of \$3,587 in construction work in progress, an increase of \$30 in land and rights-of-way, offset by a decrease of \$276 in intangible assets.

With the adoption of GASB Statement 51, Hetch Hetchy Power reclassified \$17,141 of electric meter software and emission reduction credits in intangible assets net of depreciation as of June 30, 2010. In fiscal year 2012 and 2011, total intangible assets net of depreciation were \$16,723 and \$16,999 for Hetch Hetchy Power, respectively.

For the year ended June 30, 2012, Hetch Hetchy Power's major additions to construction work in progress totaled \$39,595 (see Table 3D-1), and major depreciable facilities, improvements, intangible assets, machinery and equipment placed in service totaled \$35,801 (see Table 3D-2).

525 Golden Gate Avenue Headquarters Project

As of June 30, 2012, the Power Enterprise has incurred \$17,520 in construction costs for the 525 Golden Gate Headquarters project. In addition, the Power Enterprise has incurred \$6,915 in energy efficiency building upgrades including solar power panels, solar controls, wind power, and Heating Ventilation Air Conditioning (HVAC). The building consolidated divisions of the San Francisco Public Utilities Commission that were renting space at multiple locations in the Civic Center. Construction started in January 2010 and several SFPUC bureaus have relocated to the headquarters as of June 30, 2012. The entire relocation was completed by end of July 2012.

Capital Assets, Fiscal Year 2011

Hetch Hetchy Water and Power

Hetch Hetchy has net capital assets of \$303,418 invested in both water and power utility capital assets as of June 30, 2011 (see Table 3A). This amount represents an increase of \$17,648 or 6.2%, resulting from an increase of \$24,335 in construction work in progress offset by decreases of \$6,338 in facilities, improvements, machinery and equipment, and \$349 in intangible assets, net of depreciation.

The investment in capital assets includes land, buildings, improvements, hydropower facilities, dams, transmission lines, machinery, and equipment.

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Major additions to construction work in progress during the year ended June 30, 2011 include:

**Table 3E – 1 Hetch Hetchy Water and Power
Major Additions to Construction Work in Progress**

Year ended June 30, 2011

	Hetch Hetchy Water	Hetch Hetchy Power	Total 2011 Hetch Hetchy Water & Power
525 Golden Gate Avenue Headquarters Project	\$ —	7,673	7,673
Exciters, switchgear and breakers	—	2,517	2,517
Switchyard Upgrades	—	2,200	2,200
Western Energy Coordinating Council Compliance Program	—	1,406	1,406
San Joaquin Pipeline Rehabilitation Transmission/Distribution	1,171	—	1,171
System/Assessment/Rehabilitation	—	1,064	1,064
Hetchy Governors Rehabilitation	—	951	951
MUNI Woods Coach	—	917	917
Other project additions individually below \$900	3,603	10,760	14,363
	<u>\$ 4,774</u>	<u>27,488</u>	<u>32,262</u>

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Major depreciable facilities, improvements, intangible assets, machinery and equipment placed in service, including transfers of completed projects from construction work in progress, during the year ended June 30, 2011 include:

**Table 3E – 2 Hetch Hetchy Water and Power
Major Facilities, Improvements, Intangible Assets, Machinery and Equipment
Placed in Service**

Year ended June 30, 2011

	Hetch Hetchy Water	Hetch Hetchy Power	Total 2011 Hetch Hetchy Water & Power
Streetlights at Van Ness	\$ —	970	970
Emergency Generator	272	333	605
Static Excitation Redundant System	—	487	487
Cottage #4, 20, 21, 23, & 27 Remodel	216	263	479
Water tanks at O'Shaughnessy	205	251	456
Other project additions individually below \$400	920	3,107	4,027
	\$ 1,613	5,411	7,024

Hetch Hetchy Water

Hetch Hetchy Water has net capital assets of \$85,508 invested in a broad range of utility capital assets as of June 30, 2011 (see Table 3B). This amount represents a decrease of \$1,126 or 1.3%, primarily due to decreases of \$4,005 major additions net of depreciation in facilities, improvements, machinery and equipment, and \$207 in intangible assets, offset by an increase in construction work in progress of \$3,086.

For the year ended June 30, 2011, Hetch Hetchy Water's major additions to construction work in progress totaled \$4,774 (see Table 3E-1). Major depreciable facilities, improvements, intangible assets, machinery and equipment placed in service totaled \$1,613 (see Table 3E-2).

Hetch Hetchy Power

Hetch Hetchy Power has net capital assets of \$217,910 invested in power utility capital assets as of June 30, 2011 (see Table 3C). This amount represents an increase of \$18,774 or 9.4%, primarily due to an increase of \$21,249 in construction work in progress, offset by decreases of \$2,333 major additions net of depreciation in facilities, improvements, machinery and equipment, and \$142 in intangible assets.

For the year ended June 30, 2011, Hetch Hetchy Power's major additions to construction work in progress totaled \$27,488 (see Table 3E-1), and major depreciable facilities, improvements, intangible assets, machinery and equipment placed in service totaled \$5,411 (see Table 3E-2).

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525 Golden Gate Avenue Headquarters Building

As of June 30, 2011, the Power Enterprise has incurred \$12,302 in construction costs for the project. The building is intended to consolidate divisions of the San Francisco Public Utilities Commission that are currently renting space at multiple locations in the Civic Center area. Demolition of the existing site was completed in June 2009. Construction started in January 2010 with expected completion in June 2012.

Debt Administration

Hetch Hetchy Water and Power

As of June 30, 2012, Hetch Hetchy Water and Power has outstanding certificates of participation, Clean Renewable Energy Bonds (CREBs), Qualified Energy Conservation Bonds (QECCBs), and New Clean Renewable Energy Bonds (NCREBs). See Hetch Hetchy Power section below for more details.

Hetch Hetchy Water

Hetch Hetchy Water did not have any debt outstanding in the fiscal years 2012 and 2011.

Hetch Hetchy Power

As of June 30, 2012 and 2011, Hetch Hetchy Power has outstanding debt of \$35,955 and \$21,527, respectively, as shown in Table 4.

**Table 4 – Hetch Hetchy Power
Outstanding Debt, Net of Unamortized Costs, Discount, and Premium**

June 30, 2012, 2011 and 2010

	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2012-2011 Change</u>	<u>2011-2010 Change</u>
Clean Renewable Energy Bonds	\$ 4,493	4,902	5,310	(409)	(408)
Certificates of participation Series 2009C	3,978	4,032	4,083	(54)	(51)
Certificates of participation Series 2009D (BABs)	12,593	12,593	12,593	—	—
Qualified energy conservation bonds	8,291	—	—	8,291	—
New clean renewable energy bonds	6,600	—	—	6,600	—
Total	<u>\$ 35,955</u>	<u>21,527</u>	<u>21,986</u>	<u>14,428</u>	<u>(459)</u>

Total debt outstanding at June 30, 2012 consisted of \$16,571 in Certificates of Participation, \$8,291 in taxable Qualified Energy Conservation Bonds (QECCBs), \$6,600 in taxable New Clean Renewable Energy Bonds (NCREBs), and \$4,493 in Clean Renewable Energy Bonds (CREBs). The increase in debt is due to issuance of two new bonds during the year, QECCBs for \$8,291 and NCREBs for \$6,600, offset by a payment towards CREBs of \$422 less \$13 discount amortization, and certificates of participation premium amortization of \$54.

HETCH HETCHY WATER AND POWER

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(Dollars in thousands, unless otherwise stated)

CREBs in the amount of \$6,325 were issued in accordance with the Energy Tax Incentives Act of 2005 to fund solar photovoltaic projects in November 2008. These bonds qualified as no interest, tax credit bonds with a term of fifteen years. Annual payments in the amount of \$422 are due on December 15 beginning in 2008.

QECBs in the amount of \$8,291 were issued in December 2011 to fund qualified green energy efficiency projects for the Commission's 525 Golden Gate Headquarters project. QECBs have a tax credit IRS subsidy and have a term of fifteen years. Semi-annual principal and interest payments are due on June 15 and December 15 with the first payment of \$589 due in December 2012.

NCREBs were issued for \$6,600 in April 2012 to fund certain qualified facilities that will provide clean, renewable energy at Davies Symphony Hall, City Hall, and University Mount Reservoir. NCREBs have a tax credit IRS subsidy and have a term of sixteen years. Semi-annual principal and interest payments are due on April 25 and October 25 with the first payment of \$457 due in April 2013.

More detailed information on Hetch Hetchy Power's long-term liabilities is presented in Note 6 to the financial statements.

Next Year's Rates

Hetch Hetchy Water

Assessment fees to the Water Enterprise will increase from \$30.6 million to \$35.1 million as reflected in the fiscal year 2013 adopted budget. All other up-country retail rates will remain the same with the exception of one rate to Lawrence Livermore District which will increase by 12.8% effective July 1, 2012 because of approved resolution dated February 8, 2011 to increase rates for commercial and industrial users.

Hetch Hetchy Power

Hetch Hetchy Power's electric revenue requirement model was completed in September 2009. The electric retail rate setting process in conjunction with an independent rate study is required by City Charter. In fiscal year 2012, Hetch Hetchy Power charged the General Fund City departments on average \$0.0375 per kilowatt hours (kWh) and other City enterprise departments are charged at the PG&E scheduled rates. On December 11, 2011, the SFPUC approved a four-year rate increase plan for select public agencies including the General Fund City departments. The plan includes a \$0.0050/kWh increase per year, starting July 1, 2013 and continuing in \$0.0050/kWh increments annually each July until a total \$0.02/kWh increase is reached. For fiscal year 2012, the Modesto Irrigation District (MID) and Turlock Irrigation District (TID) class one rates were \$0.02789 kWh and \$0.02495 kWh, respectively. MID/TID rates get trued up every year based on actuals. Under an existing development agreement, Hetch Hetchy Power will construct, own and operate the electric distribution infrastructure required to provide retail electric service to residential and commercial customers in Parcel "A" of the former Hunter's Point Shipyard. Public power rates for redevelopment areas in San Francisco were adopted on February 8, 2011. These rates were in effect until June 30, 2012. Effective July 1, 2012 and each successive July 1, the rates are adjusted by the lesser of the annual percentage in the Consumer Price Index (CPI) or the change of the PG&E scheduled rates. To date, Hetch Hetchy Power has prepared service standards, developed system plans and specifications, acquired materials and equipment, and initiated construction of primary distribution facilities.

HETCH HETCHY WATER AND POWER

Management's Discussion and Analysis

June 30, 2012 and 2011

(Dollars in thousands, unless otherwise stated)

Request for Information

This report is designed to provide our citizens, customers, investors, and creditors with an overview of Hetch Hetchy's finances and to demonstrate Hetch Hetchy Water and Power's respective accountability for the money it receives. Questions regarding any of the information provided in this report or requests for additional financial information should be addressed to San Francisco Public Utilities Commission, Chief Financial Officer, 525 Golden Gate Avenue, 13th Floor, San Francisco, CA 94102.

HETCH HETCHY WATER AND POWER

Statements of Net Assets

June 30, 2012 and 2011

(In thousands)

	<u>Hetch Hetchy Water</u>	<u>Hetch Hetchy Power</u>	<u>2012 Total</u>	<u>Hetch Hetchy Water</u>	<u>Hetch Hetchy Power</u>	<u>2011 Total</u>
Assets:						
Current assets:						
Cash and investments with City Treasury	\$ 43,887	155,773	199,660	35,128	159,868	194,996
Cash and investments outside City Treasury	2	8	10	2	8	10
Receivables:						
Charges for services (net of allowance for doubtful accounts of \$0 in 2012 and 2011)	269	10,637	10,906	416	12,666	13,082
Due from other City departments, current portion	—	2,207	2,207	13,638	1,178	14,816
Due from other governments	—	62	62	—	636	636
Interest receivables	75	26	101	—	—	—
Other receivables	11	16	27	34	172	206
Total receivables	355	12,948	13,303	14,088	14,652	28,740
Deferred charges and other assets	10	4,930	4,940	—	3,262	3,262
Inventories	138	158	296	152	174	326
Total current assets	44,392	173,817	218,209	49,370	177,964	227,334
Restricted assets:						
Restricted assets – cash and investments with City Treasury	14,880	6,599	21,479	—	—	—
Restricted assets – cash and investments outside City Treasury	—	3,252	3,252	—	12,192	12,192
Restricted – interest receivable	13	247	260	—	—	—
Non-current assets:						
Capital assets, not being depreciated	17,254	55,042	72,296	14,437	51,425	65,862
Capital assets, net of accumulated depreciation	70,687	192,412	263,099	71,071	166,485	237,556
Due from other City departments	—	17,059	17,059	—	14,662	14,662
Bond issuance costs, net of accumulated amortization of \$39 in 2012 and \$24 in 2011	—	325	325	—	192	192
Total non-current assets	102,834	274,936	377,770	85,508	244,956	330,464
Total assets	147,226	448,753	595,979	134,878	422,920	557,798
Liabilities:						
Current liabilities:						
Accounts payable	1,178	18,450	19,628	1,745	11,884	13,629
Accrued payroll	746	2,047	2,793	607	1,645	2,252
Accrued vacation and sick leave, current portion	518	1,116	1,634	436	1,016	1,452
Accrued workers' compensation, current portion	133	300	433	99	259	358
Due to other funds	—	214	214	—	3,250	3,250
Damage claims liability, current portion	65	464	529	15	403	418
Deposits, advances, and other liabilities	6	60	66	24	1,031	1,055
Bond and loan interest payable	—	429	429	—	164	164
Revenue bonds, current portion	—	1,009	1,009	—	422	422
Certificates of participation, current portion	—	268	268	—	—	—
Current liabilities payable from restricted assets	723	109	832	—	669	669
Total current liabilities	3,369	24,466	27,835	2,926	20,743	23,669
Long-term liabilities:						
Other post-employment benefits obligation	5,055	9,247	14,302	3,669	7,552	11,221
Accrued vacation and sick leave, less current portion	444	1,006	1,450	304	834	1,138
Accrued workers' compensation, less current portion	574	1,314	1,888	492	1,213	1,705
Damage claims liability, less current portion	230	1,912	2,142	53	1,659	1,712
Revenue bonds, less current portion	—	18,375	18,375	—	4,480	4,480
Certificates of participation, less current portion	—	16,303	16,303	—	16,625	16,625
Pollution remediation obligation	1,032	—	1,032	1,340	—	1,340
Total long-term liabilities	7,335	48,157	55,492	5,858	32,363	38,221
Total liabilities	10,704	72,623	83,327	8,784	53,106	61,890
Net assets:						
Invested in capital assets, net of related debt	87,941	221,699	309,640	85,508	208,092	293,600
Restricted for capital projects	14,170	112	14,282	—	—	—
Unrestricted	34,411	154,319	188,730	40,586	161,722	202,308
Total net assets	\$ 136,522	376,130	512,652	126,094	369,814	495,908

See accompanying notes to financial statements

HETCH HETCHY WATER AND POWER

Statements of Revenues, Expenses, and Changes in Net Assets

Years ended June 30, 2012 and 2011

(In thousands)

	<u>Hetch Hetchy Water</u>	<u>Hetch Hetchy Power</u>	<u>2012 Total</u>	<u>Hetch Hetchy Water</u>	<u>Hetch Hetchy Power</u>	<u>2011 Total</u>
Operating revenues:						
Charges for services	\$ 32,386	94,680	127,066	31,326	108,454	139,780
Rents and concessions	109	134	243	115	140	255
Total operating revenues	<u>32,495</u>	<u>94,814</u>	<u>127,309</u>	<u>31,441</u>	<u>108,594</u>	<u>140,035</u>
Operating expenses:						
Personnel services	12,856	31,719	44,575	11,327	28,474	39,801
Contractual services	1,090	4,726	5,816	1,108	6,063	7,171
Transmission/distribution and other power costs	—	16,785	16,785	—	18,036	18,036
Purchased electricity	—	4,754	4,754	—	1,233	1,233
Materials and supplies	1,208	1,694	2,902	1,069	1,638	2,707
Depreciation	4,059	9,796	13,855	4,125	9,582	13,707
Services provided by other departments	984	4,840	5,824	1,261	4,164	5,425
General and administrative and other	16,806	19,293	36,099	13,589	17,051	30,640
Total operating expenses	<u>37,003</u>	<u>93,607</u>	<u>130,610</u>	<u>32,479</u>	<u>86,241</u>	<u>118,720</u>
Operating income (loss)	<u>(4,508)</u>	<u>1,207</u>	<u>(3,301)</u>	<u>(1,038)</u>	<u>22,353</u>	<u>21,315</u>
Nonoperating revenues (expenses):						
Federal grants	—	2,581	2,581	—	4,730	4,730
Interest and investment income	874	2,589	3,463	220	1,965	2,185
Other nonoperating revenues	57	3,219	3,276	193	2,694	2,887
Interest expense	—	(99)	(99)	—	(562)	(562)
Other nonoperating expenses	(68)	(3,179)	(3,247)	(68)	(4,403)	(4,471)
Net nonoperating revenues	<u>863</u>	<u>5,111</u>	<u>5,974</u>	<u>345</u>	<u>4,424</u>	<u>4,769</u>
Net income (loss) before transfers	<u>(3,645)</u>	<u>6,318</u>	<u>2,673</u>	<u>(693)</u>	<u>26,777</u>	<u>26,084</u>
Transfers in (out)	<u>14,073</u>	<u>(2)</u>	<u>14,071</u>	<u>13,638</u>	<u>(184)</u>	<u>13,454</u>
Changes in net assets	<u>10,428</u>	<u>6,316</u>	<u>16,744</u>	<u>12,945</u>	<u>26,593</u>	<u>39,538</u>
Net assets at beginning of year	<u>126,094</u>	<u>369,814</u>	<u>495,908</u>	<u>113,149</u>	<u>343,221</u>	<u>456,370</u>
Net assets at end of year	<u>\$ 136,522</u>	<u>376,130</u>	<u>512,652</u>	<u>126,094</u>	<u>369,814</u>	<u>495,908</u>

See accompanying notes to financial statements.

HETCH HETCHY WATER AND POWER

Statements of Cash Flows

Years ended June 30, 2012 and 2011

(In thousands)

	Hetch Hetchy Water	Hetch Hetchy Power	2012 Total	Hetch Hetchy Water	Hetch Hetchy Power	2011 Total
Cash flows from operating activities:						
Cash received from customers, including cash deposits	\$ 32,538	87,850	120,388	31,262	109,200	140,462
Cash received from tenants for rent	109	134	243	115	140	255
Cash paid to employees for services	(10,666)	(28,752)	(39,418)	(9,754)	(26,307)	(36,061)
Cash paid to suppliers for goods and services	(18,689)	(42,949)	(61,638)	(16,886)	(44,238)	(61,124)
Cash received for license fees	—	2,057	2,057	—	2,000	2,000
Cash from miscellaneous revenues	48	83	131	153	68	221
Cash received from settlements	—	540	540	28	7,196	7,224
Cash paid for rebates and program incentives	(68)	(3,179)	(3,247)	(68)	(4,402)	(4,470)
Cash paid for judgments and claims	(694)	(1,509)	(2,203)	(746)	(1,734)	(2,480)
Net cash provided by operating activities	<u>2,578</u>	<u>14,275</u>	<u>16,853</u>	<u>4,104</u>	<u>41,923</u>	<u>46,027</u>
Cash flows from noncapital and related financing activities:						
Federal and state grants	—	3,155	3,155	—	4,264	4,264
Transfers in (out)	27,711	(2)	27,709	—	(184)	(184)
Net cash provided by noncapital financing activities	<u>27,711</u>	<u>3,153</u>	<u>30,864</u>	<u>—</u>	<u>4,080</u>	<u>4,080</u>
Cash flows from capital and related financing activities:						
Acquisition and construction of capital assets	(7,445)	(40,056)	(47,501)	(3,220)	(33,472)	(36,692)
Proceeds from sale of capital assets	9	12	21	13	16	29
Issuance costs paid on long-term debt	—	(147)	(147)	—	—	—
Principal payments on bond debt	—	(422)	(422)	—	(422)	(422)
Proceeds from revenue bonds	—	14,891	14,891	—	—	—
Interest paid on loans payable	—	(985)	(985)	—	(984)	(984)
Subsidy interest income from Build America Bonds	—	285	285	—	284	284
Net cash used in capital and related financing activities	<u>(7,436)</u>	<u>(26,422)</u>	<u>(33,858)</u>	<u>(3,207)</u>	<u>(34,578)</u>	<u>(37,785)</u>
Cash flows from investing activities:						
Interest income received	786	2,558	3,344	245	2,043	2,288
Proceeds from sale of investments outside City Treasury	—	41,652	41,652	—	22,444	22,444
Purchases of investments outside City Treasury	—	(37,424)	(37,424)	—	(27,863)	(27,863)
Net cash provided by (used in) investing activities	<u>786</u>	<u>6,786</u>	<u>7,572</u>	<u>245</u>	<u>(3,376)</u>	<u>(3,131)</u>
Increase (decrease) in cash and cash equivalents	23,639	(2,208)	21,431	1,142	8,049	9,191
Cash and cash equivalents:						
Beginning of year	35,130	166,649	201,779	33,988	158,600	192,588
End of year	<u>\$ 58,769</u>	<u>164,441</u>	<u>223,210</u>	<u>35,130</u>	<u>166,649</u>	<u>201,779</u>
Reconciliation of cash and cash equivalents to the statements of net assets:						
Cash and investments with City Treasury:						
Unrestricted	\$ 43,887	155,773	199,660	35,128	159,868	194,996
Restricted	14,880	6,599	21,479	—	—	—
Cash and investments outside City Treasury:						
Unrestricted	2	8	10	2	8	10
Restricted	—	3,252	3,252	—	12,192	12,192
Restricted (with maturity more than 90 days – see table in note 3)	—	(1,191)	(1,191)	—	(5,419)	(5,419)
Cash and cash equivalents at end of year on statement of cash flows	<u>\$ 58,769</u>	<u>164,441</u>	<u>223,210</u>	<u>35,130</u>	<u>166,649</u>	<u>201,779</u>

HETCH HETCHY WATER AND POWER

Statements of Cash Flows

Years ended June 30, 2012 and 2011

(In thousands)

	Hetch Hetchy Water	Hetch Hetchy Power	2012 Total	Hetch Hetchy Water	Hetch Hetchy Power	2011 Total
Reconciliation of operating income to net cash provided by operating activities:						
Operating income (loss)	\$ (4,508)	1,207	(3,301)	(1,038)	22,353	21,315
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:						
Depreciation	4,059	9,796	13,855	4,125	9,582	13,707
Write-off of capital assets	750	867	1,617	229	1,908	2,137
Amortization of bond discount and issuance	—	(27)	(27)	—	(24)	(24)
Miscellaneous revenues	48	83	131	153	68	221
Settlements	—	540	540	28	7,196	7,224
Rebates and program incentives	(68)	(3,179)	(3,247)	(68)	(4,402)	(4,470)
License fees	—	2,057	2,057	—	2,000	2,000
Changes in operating assets and liabilities:						
Receivables:						
Charges for services	147	2,029	2,176	(52)	68	16
Due to (from) other City departments	—	(8,044)	(8,044)	—	659	659
Other receivables	23	156	179	(33)	(172)	(205)
Deferred charges and other assets	(10)	(1,668)	(1,678)	—	(612)	(612)
Inventories	14	16	30	(18)	(21)	(39)
Accounts payable	359	8,588	8,947	(1,792)	1,146	(646)
Accrued payroll	139	402	541	12	166	178
Accrued other post-employment benefits obligation	1,386	1,695	3,081	1,238	1,511	2,749
Accrued vacation and sick leave	222	272	494	—	11	11
Accrued workers' compensation	116	142	258	(2)	(3)	(5)
Pollution remediation obligation	(308)	—	(308)	1,340	—	1,340
Damage claims liability	227	314	541	(39)	298	259
Deposits, advances, and other liabilities	(18)	(971)	(989)	21	191	212
Total adjustments	7,086	13,068	20,154	5,142	19,570	24,712
Net cash provided by operating activities	\$ 2,578	14,275	16,853	4,104	41,923	46,027
Noncash transaction:						
Accrued capital asset costs	\$ 723	109	832	926	2,691	3,617
Interfund loan payable	—	214	214	—	3,250	3,250

See accompanying notes to financial statements.

HETCH HETCHY WATER AND POWER

Notes to Financial Statements

June 30, 2012 and 2011

(Dollars in thousands, unless otherwise stated)

(1) Description of Reporting Entity

Hetch Hetchy was established as a result of the Raker Act of 1913, which granted water and power resources rights-of-way on the Tuolumne River in Yosemite National Park and Stanislaus National Forest to the City. Hetch Hetchy is a stand-alone enterprise comprised of two funds, Hetch Hetchy Power (AKA the Power Enterprise) and Hetch Hetchy Water, a portion of the Water Enterprise's operations, specifically the up-country water supply and transmission service for the latter. Hetch Hetchy accounts for the activities of Hetch Hetchy Water and Power and is engaged in the collection and conveyance of approximately 85% of the City's water supply and in the generation and transmission of electricity from that resource.

Approximately 68% of the electricity generated by Hetch Hetchy Power is used to provide electric service to the City's municipal customers (including the San Francisco Municipal Transportation Agency, Recreation and Parks Department, the Port of San Francisco, the San Francisco International Airport and its tenants, San Francisco General Hospital, street lights, Moscone Convention Center, and the Water and Wastewater Enterprises). The majority of the remaining 32% balance of electricity is sold to other utility districts, such as the Turlock and Modesto Irrigation Districts. As a result of the 1913 Raker Act, energy produced above the City's Municipal Load is sold first to Modesto and Turlock Irrigation Districts (the Districts) to cover their pumping and municipal load needs and any remaining energy is either sold to other municipalities and/or government agencies (not for resale) or deposited into an energy bank account under the City's agreement with Pacific Gas and Electric Company (PG&E). Hetch Hetchy consists of a system of reservoirs, hydroelectric power plants, aqueducts, pipelines, and transmission lines. This system carries water and power more than 165 miles from the Sierra Nevada to customers in the City and portions of the surrounding San Francisco Bay Area.

Hetch Hetchy also purchases wholesale electric power from various energy providers that are used in conjunction with owned hydro resources to meet the power requirements of its customers. Operations and business decisions can be greatly influenced by market conditions, State and Federal power matters before the California Public Utilities Commission (CPUC), the California Independent System Operator (CAISO), and the Federal Energy Regulatory Commission (FERC). Therefore, Hetch Hetchy serves as the City's representative at CPUC, CAISO and FERC forums and continues to monitor regulatory proceedings.

Until August 1, 2008, the Commission consisted of five members, all appointed by the Mayor. Proposition E, a City and County of San Francisco Charter amendment approved by the voters in the June 3, 2008 election, terminated the terms of all five existing members of the Commission, changed the process for appointing new members, and set qualifications for all members. Under the amended Charter, the Mayor continues to nominate candidates to the Commission, but nominees do not take office until the Board of Supervisors votes to approve their appointments by a majority (at least six members). The amended Charter provides for staggered four-year terms for the Commission members and requires them to meet the following qualifications:

- Seat 1 must have experience in environmental policy and an understanding of environmental justice issues.
- Seat 2 must have experience in ratepayer or consumer advocacy.

HETCH HETCHY WATER AND POWER

Notes to Financial Statements

June 30, 2012 and 2011

(Dollars in thousands, unless otherwise stated)

- Seat 3 must have experience in project finance.
- Seat 4 must have expertise in water systems, power systems, or public utility management.
- Seat 5 is an at-large member.

The Commission is a department of the City, and as such, the financial operations of Hetch Hetchy, Wastewater, and the Water Enterprises are included in the Comprehensive Annual Financial Report of the City as enterprise funds. These financial statements are intended to present only the financial position, and the changes in financial position and cash flows of only that portion of the City that is attributable to the transactions of Hetch Hetchy. They do not purport to, and do not, present fairly the financial position of the City as of June 30, 2012 and 2011, and the changes in its financial position, or, where applicable, the cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

(2) Significant Accounting Policies

(a) *Basis of Accounting and Measurement Focus*

The accounts of Hetch Hetchy are organized on the basis of proprietary fund types and are included as enterprise funds of the City. The activities of Hetch Hetchy and each fund are accounted for with a separate set of self-balancing accounts that comprise Hetch Hetchy's and each fund's assets, liabilities, net assets, revenues, and expenses. Enterprise funds account for activities (i) that are financed with debt that is secured solely by a pledge of the net revenues from fees and charges of the activity; or (ii) that are required by laws or regulations that the activity's costs of providing services, including capital costs (such as depreciation or debt service), be recovered with fees and charges, rather than with taxes or similar revenues; or (iii) that the pricing policies of the activity establish fees and charges designed to recover its costs, including capital costs (such as depreciation or debt service).

The financial activities of Hetch Hetchy are accounted for on a flow of economic resources measurement focus, using the accrual basis of accounting. Under this method, all assets and liabilities associated with operations are included on the statements of net assets; revenues are recognized when earned, and expenses are recognized when liabilities are incurred. Operating revenues are defined as charges to customers and rental income.

Hetch Hetchy does not apply Financial Accounting Standards Board (FASB) statements and interpretations issued after November 30, 1989. Hetch Hetchy applies all applicable Governmental Accounting Standards Board (GASB) pronouncements, as well as statements and interpretations of FASB, Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

(b) *Cash and Cash Equivalents*

Hetch Hetchy considers its pooled deposits and investments held with the City Treasury to be demand deposits and, therefore, cash and cash equivalents for financial reporting. Nonpooled

HETCH HETCHY WATER AND POWER

Notes to Financial Statements

June 30, 2012 and 2011

(Dollars in thousands, unless otherwise stated)

restricted deposits and restricted deposits and investments held outside the City Treasury with maturities of three months or less are considered to be cash equivalents.

(c) ***Investments***

Money market funds are carried at cost, which approximates fair value. All other investments are stated at fair value based upon quoted market prices. Changes in fair value are recognized as investment gains or losses and are recorded as a component of nonoperating revenues.

(d) ***Deferred Charges***

Deferred charges consist of costs incurred to generate the power that has been placed in the Municipal Deviation and Deferred Delivery Accounts under the provisions of the interconnection agreement with PG&E (see note 12(a)).

(e) ***Inventory***

Inventory consists primarily of construction materials and maintenance supplies and is valued at average cost. Inventory is expensed as it is consumed.

(f) ***Capital Assets***

Capital assets are defined as assets with an initial individual cost of more than \$5 and an estimated useful life in excess of one year. Capital assets with an original acquisition date prior to July 1, 1977 are recorded in the financial statements at estimated cost, as determined by an independent professional appraisal, or at cost, if known. All subsequent acquisitions have been recorded at cost. All donated capital assets are valued at estimated fair value at the time of donation. Depreciation and amortization are computed using the straight-line method over the estimated useful lives of the related assets, which range from 1 to 100 years. No depreciation or amortization is recorded in the year of acquisition, and a full year's depreciation or amortization is recorded in the year of disposal.

(g) ***Intangible Assets***

Under GASB Statement 51, *Accounting and Financial Reporting for Intangible Assets*, intangible assets are defined as identifiable, nonfinancial assets capable of being separated, sold, transferred, or licensed, and include contractual or legal rights. Examples of intangible assets include rights-of-way easements, land use rights, water rights, licenses, and permits. The accounting pronouncement also provides guidance on the capitalization of internally generated intangible assets, such as the development and installation of computer software by or on behalf of the reporting entity.

According to the standard, Hetch Hetchy is required to capitalize intangible assets with a useful life extending beyond one reporting period. Hetch Hetchy has established a capitalization threshold of \$100. GASB Statement 51 also requires amortization of intangible assets over the benefit period, except for certain assets having an indefinite useful life. Assets with an indefinite useful life generally provide a benefit that is not constrained by legal or contractual limitations or any other external factor, and therefore, are not amortized.

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As of June 30, 2011, Hetch Hetchy intangible assets net of depreciation were \$12,653 and \$16,999 for Hetch Hetchy Water and Hetch Hetchy Power, respectively. Hetch Hetchy did not have any new additions to intangible assets as of June 30, 2012, and intangible asset balances net of depreciation were \$12,446 and \$16,723 for Hetch Hetchy Water and Hetch Hetchy Power, respectively.

(h) Construction Work In Progress

The cost of acquisition and construction of major plant and equipment is recorded as construction work in progress. Costs of construction projects that are discontinued are recorded as expense in the year in which the decision is made to discontinue such projects.

(i) Bond Discount, Premium, and Issuance Costs

Bond discount, premium, and issuance costs are amortized over the term of the related bonds on a method which approximates the effective interest method basis.

(j) Accrued Vacation and Sick Leave

Accrued vacation pay, which may be accumulated up to ten weeks per employee, is charged to expense as earned. Sick leave earned subsequent to December 6, 1978 is nonvesting and may be accumulated up to six months per employee.

(k) Workers' Compensation

Hetch Hetchy is self-insured for workers' compensation claims and accrues the estimated cost of those claims, including the estimated cost of incurred but not reported claims.

(l) Damage Claims Liability

Hetch Hetchy is self-insured for general liability and uninsurable property damage claims. Commercially uninsurable property includes assets that are underground or provide transmission and distribution. Maintained commercial coverage does not cover claims attributed to loss from earthquake, contamination, pollution remediation efforts and other specific naturally occurring contaminants such as mold. The liability represents an estimate of the cost of all outstanding claims, including adverse loss development, and estimated incurred but not reported claims.

(m) Arbitrage Rebate Requirement

Certain bonds are subject to arbitrage rebate requirements in accordance with regulations issued by the U.S. Treasury Department. The requirements of the Clean Renewable Energy Bonds (CREBs) and the New Clean Renewable Energy Bonds (NCREBs) stipulate that the first payment of excess investment earnings if any, is required to be rebated to the Federal government, no later than sixty days after the end of the fifth bond year of the agreement. Hetch Hetchy did not have any arbitrage liability as of June 30, 2012 and 2011.

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(Dollars in thousands, unless otherwise stated)

(n) Income Taxes

As a government agency, Hetch Hetchy is exempt from both Federal income taxes and California State franchise taxes.

(o) Revenue Recognition

Water and power revenues are based on water and power consumption and billing rates. Generally, customers are billed monthly. Revenues earned but unbilled are accrued as charges for services receivables on the statements of net assets.

(p) Use of Estimates

The preparation of 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 the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(q) Reclassifications

Certain reclassifications have been made to prior year amounts to conform to current year presentation.

(r) Accounting and Financial Reporting for Pollution Remediation Obligations

According to GASB Statement 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, a government would have to estimate its expected outlays for pollution remediation if it knows a site is polluted and any of the following recognition triggers occur:

- Pollution poses an imminent danger to the public or environment and a government has little or no discretion to avoid fixing the problem;
- A government has violated a pollution prevention-related permit or license;
- A regulator has identified (or evidence indicates it will identify) a government as responsible (or potentially responsible) for cleaning up pollution, or for paying all or some of the cost of the cleanup;
- A government is named (or evidence indicates that it will be named) in a lawsuit to compel it to address the pollution; or
- A government begins or legally obligates itself to begin cleanup or post-cleanup activities (limited to amounts the government is legally required to complete).

As a part of ongoing operations, situations may occur requiring the removal of pollution or other hazardous material. These situations typically arise in the process of acquiring an asset, preparing an asset for its intended use, or during the Design Phase of projects under review by the Project Managers. Other times, pollution may arise during the implementation and construction of a major or

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minor capital project. Examples of pollution may include, but are not limited to: asbestos or lead paint removal; leaking of sewage in underground pipes or neighboring areas; chemical spills; removal and disposal of known toxic waste; harmful biological and chemical pollution of water; or contamination of surrounding soils by underground storage tanks.

As of June 30, 2012 and 2011, the pollution remediation obligation reported in the accompanying statements of net assets was \$1,032 and \$1,340, respectively.

(3) Cash, Cash Equivalents and Investments

Hetch Hetchy's cash, cash equivalents and investments with the City Treasury are invested in an unrated City pool pursuant to investment policy guidelines established by the City Treasurer. The objectives of the policy guidelines are, in order of priority, preservation of capital, liquidity, and yield. The policy addresses soundness of financial institutions in which the City will deposit funds, types of investment instruments as permitted by the California Government Code, and the percentage of the portfolio which may be invested in certain instruments with longer terms to maturity. The City Treasurer allocates income from the investment of pooled cash at month end in proportion to Hetch Hetchy's average daily cash balances. The primary objectives of Hetch Hetchy's investment policy are consistent with the City's policy.

Hetch Hetchy's cash, cash equivalents and investments are shown on the accompanying statements of net assets as follows:

	Hetch Hetchy Water	Hetch Hetchy Power	Total 2012 Hetch Hetchy Water & Power
Current and noncurrent assets:			
Pooled cash and investments with City Treasury	\$ 58,767	162,372	221,139
Nonpooled cash and investments outside City Treasury	2	3,260	3,262
Total cash, cash equivalents, and investments	\$ 58,769	165,632	224,401

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Notes to Financial Statements

June 30, 2012 and 2011

(Dollars in thousands, unless otherwise stated)

	<u>Hetch Hetchy Water</u>	<u>Hetch Hetchy Power</u>	<u>Total 2011 Hetch Hetchy Water & Power</u>
Current and noncurrent assets:			
Pooled cash and investments with City Treasury	\$ 35,128	159,868	194,996
Nonpooled cash and investments outside City Treasury	<u>2</u>	<u>12,200</u>	<u>12,202</u>
Total cash, cash equivalents, and investments	<u>\$ 35,130</u>	<u>172,068</u>	<u>207,198</u>

The following table shows the percentage distribution of the City's pooled investment by maturity as of June 30, 2012:

<u>Investment maturities (in months)</u>			
<u>Under 1</u>	<u>1 to less than 6</u>	<u>6 to less than 12</u>	<u>12 – 60</u>
1.9%	11.1%	8.0%	79.0%

The following table shows the percentage distribution of the City's pooled investment by maturity as of June 30, 2011:

<u>Investment maturities (in months)</u>			
<u>Under 1</u>	<u>1 to less than 6</u>	<u>6 to less than 12</u>	<u>12 – 60</u>
1.3%	13.2%	13.4%	72.1%

Nonpooled cash outside of the investment pool is \$3,262 and \$12,202 at June 30, 2012 and 2011, respectively. The balance as of June 30, 2012 included CREBs proceeds of \$1,484 deposited into a Federal Deposit Insurance Corporation (FDIC) insured money market fund with a weighted average maturity of 55 days, certificates of participation proceeds of \$1,593, commercial paper of \$175 and \$10 held at a commercial bank in a noninterest bearing checking account that is covered by depository insurance. The account was established as provided by the City's Administrative Code. The balance as of June 30, 2011 included CREBs proceeds of \$2,589 with a weighted average maturity of 49 days, certificates of participation proceeds of \$9,603, and \$10 in a noninterest bearing checking account. The CREBs credit ratings of the money market funds invested in as of June 30, 2012 and June 30, 2011 were "AAAm" by Standard & Poor's and "Aaa-mf" by Moody's.

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(Dollars in thousands, unless otherwise stated)

The following tables shows the values of restricted cash and investments outside City Treasury by maturity as of June 30, 2012 and 2011.

Restricted Cash and Investments outside City Treasury			
Investments	Credit ratings (S&P/Moody's)	June 30, 2012	
		Maturities	Fair value
U.S. Agencies	AAA/Aaa	August 20, 2015	\$ 962
Commercial Paper	Not Applicable	February 1, 2013	175
U.S. Agencies	AAA/Aaa	October 9, 2012	54
Money Market Funds	AAA/Aaa	<90 days	2,061
Total			<u>\$ 3,252</u>

Restricted Cash and Investments outside City Treasury			
Investments	Credit ratings (S&P/Moody's)	June 30, 2011	
		Maturities	Fair value
U.S. Agencies	AAA/Aaa	August 20, 2015	\$ 962
U.S. Treasury Notes	AAA/Aaa	December 15, 2011	2,514
U.S. Agencies	AAA/Aaa	December 14, 2011	1,943
Corporate Notes	AAA/Aaa	<90 days	897
U.S. Agencies	AAA/Aaa	<90 days	3,081
Money Market Fund	AAA/Aaa	<90 days	2,795
Total			<u>\$ 12,192</u>

For fiscal year 2012, proceeds from the Certificates of Participation held as restricted cash and investments outside City Treasury in the amount of \$1,016 were invested in U.S. Treasury Bills with maturities from October 9, 2012 through August 20, 2015. The credit ratings of the Treasury Bills as of June 30, 2012 were "AAA" by Standard & Poor's and "Aaa" by Moody's.

HETCH HETCHY WATER AND POWER

Notes to Financial Statements

June 30, 2012 and 2011

(Dollars in thousands, unless otherwise stated)

(4) Capital Assets

(a) *Hetch Hetchy Water and Power*

Hetch Hetchy Water and Power capital assets as of June 30, 2012 and 2011 consist of the following:

	<u>Balance</u> <u>June 30, 2011</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance</u> <u>June 30, 2012</u>
Capital assets not being depreciated:				
Land and rights-of-way	\$ 4,665	55	—	4,720
Intangible assets	1,437	—	—	1,437
Construction work in progress	59,760	46,277	(39,898)*	66,139
Total capital assets not being depreciated	<u>65,862</u>	<u>46,332</u>	<u>(39,898)</u>	<u>72,296</u>
Capital assets being depreciated:				
Facilities and improvements	458,136	35,526	(200)	493,462
Intangible assets	45,715	—	—	45,715
Machinery and equipment	74,325	3,954	(198)	78,081
Total capital assets being depreciated	<u>578,176</u>	<u>39,480</u>	<u>(398)</u>	<u>617,258</u>
Less accumulated depreciation for:				
Facilities and improvements	(285,218)	(9,312)	127	(294,403)
Intangible assets	(17,500)	(483)	—	(17,983)
Machinery and equipment	(37,902)	(4,060)	189	(41,773)
Total accumulated depreciation	<u>(340,620)</u>	<u>(13,855)</u>	<u>316</u>	<u>(354,159)</u>
Total capital assets being depreciated, net	<u>237,556</u>	<u>25,625</u>	<u>(82)</u>	<u>263,099</u>
Total capital assets, net	<u>\$ 303,418</u>	<u>71,957</u>	<u>(39,980)</u>	<u>335,395</u>

* Includes \$1,617 in capital project write-offs primarily related to Hetch Hetchy Priest Reservoir Diversion Channel, Reservoir Valve Rehabilitation, and Moccasin Facility Upgrades.

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	Balance June 30, 2010	Increases	Decreases	Balance June 30, 2011
Capital assets not being depreciated:				
Land and rights-of-way	\$ 4,665	—	—	4,665
Intangible assets	1,437	—	—	1,437
Construction work in progress	35,425	32,932*	(8,597)*	59,760
Total capital assets not being depreciated	41,527	32,932	(8,597)	65,862
Capital assets being depreciated:				
Facilities and improvements	455,676	4,001	(1,541)	458,136
Intangible assets	45,604	111	—	45,715
Machinery and equipment	69,930	6,688	(2,293)	74,325
Total capital assets being depreciated	571,210	10,800	(3,834)	578,176
Less accumulated depreciation for:				
Facilities and improvements	(275,640)	(9,578)	—	(285,218)
Intangible assets	(17,040)	(460)	—	(17,500)
Machinery and equipment	(34,287)	(3,669)	54	(37,902)
Total accumulated depreciation	(326,967)	(13,707)	54	(340,620)
Total capital assets being depreciated, net	244,243	(2,907)	(3,780)	237,556
Total capital assets, net	\$ 285,770	30,025	(12,377)	303,418

- * Includes \$229 in capital project write-offs.
Includes a reclassification of \$670 in construction work in progress and \$3,776 in facilities and equipment between Water and Power in fiscal year 2011.

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(Dollars in thousands, unless otherwise stated)

(b) Hetch Hetchy Water

Hetch Hetchy Water capital assets as of June 30, 2012 and 2011 consist of the following:

	Balance June 30, 2011	Increases	Decreases	Balance June 30, 2012
Capital assets not being depreciated:				
Land and rights-of-way	\$ 3,003	25	—	3,028
Intangible assets	6	—	—	6
Construction work in progress	11,428	6,682	(3,890)*	14,220
Total capital assets not being depreciated	<u>14,437</u>	<u>6,707</u>	<u>(3,890)</u>	<u>17,254</u>
Capital assets being depreciated:				
Facilities and improvements	191,603	3,037	—	194,640
Intangible assets	20,522	—	—	20,522
Machinery and equipment	17,733	642	(80)	18,295
Total capital assets being depreciated	<u>229,858</u>	<u>3,679</u>	<u>(80)</u>	<u>233,457</u>
Less accumulated depreciation for:				
Facilities and improvements	(141,831)	(2,713)	—	(144,544)
Intangible assets	(7,875)	(207)	—	(8,082)
Machinery and equipment	(9,081)	(1,139)	76	(10,144)
Total accumulated depreciation	<u>(158,787)</u>	<u>(4,059)</u>	<u>76</u>	<u>(162,770)</u>
Total capital assets being depreciated, net	<u>71,071</u>	<u>(380)</u>	<u>(4)</u>	<u>70,687</u>
Total capital assets, net	<u>\$ 85,508</u>	<u>6,327</u>	<u>(3,894)</u>	<u>87,941</u>

* Includes \$750 in capital project write-offs primarily related to Hetch Hetchy Water's share of Priest Reservoir Diversion Channel, Reservoir Valve Rehabilitation, and Moccasin Facility Upgrades.

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	Balance June 30, 2010	Increases	Decreases	Balance June 30, 2011
Capital assets not being depreciated:				
Land and rights-of-way	\$ 3,003	—	—	3,003
Intangible assets	6	—	—	6
Construction work in progress	8,342	4,774	(1,688)*	11,428
Total capital assets not being depreciated	11,351	4,774	(1,688)	14,437
Capital assets being depreciated:				
Facilities and improvements	192,028	268	(693)	191,603
Intangible assets	20,522	—	—	20,522
Machinery and equipment	17,420	1,345	(1,032)	17,733
Total capital assets being depreciated	229,970	1,613	(1,725)	229,858
Less accumulated depreciation for:				
Facilities and improvements	(138,916)	(2,915)	—	(141,831)
Intangible assets	(7,668)	(207)	—	(7,875)
Machinery and equipment	(8,103)	(1,003)	25	(9,081)
Total accumulated depreciation	(154,687)	(4,125)	25	(158,787)
Total capital assets being depreciated, net	75,283	(2,512)	(1,700)	71,071
Total capital assets, net	\$ 86,634	2,262	(3,388)	85,508

- * Includes \$229 in capital project write-offs.
Includes a reclassification of \$670 in construction work in progress and \$3,776 in facilities and equipment between Water and Power in fiscal year 2011.

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(Dollars in thousands, unless otherwise stated)

(c) ***Hetch Hetchy Power***

Hetch Hetchy Power capital assets as of June 30, 2012 and 2011 consist of the following:

	<u>Balance June 30, 2011</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2012</u>
Capital assets not being depreciated:				
Land and rights-of-way	\$ 1,662	30	—	1,692
Intangible assets	1,431	—	—	1,431
Construction work in progress	<u>48,332</u>	<u>39,595</u>	<u>(36,008)*</u>	<u>51,919</u>
Total capital assets not being depreciated	<u>51,425</u>	<u>39,625</u>	<u>(36,008)</u>	<u>55,042</u>
Capital assets being depreciated:				
Facilities and improvements	266,533	32,489	(200)	298,822
Intangible assets	25,193	—	—	25,193
Machinery and equipment	<u>56,592</u>	<u>3,312</u>	<u>(118)</u>	<u>59,786</u>
Total capital assets being depreciated	<u>348,318</u>	<u>35,801</u>	<u>(318)</u>	<u>383,801</u>
Less accumulated depreciation for:				
Facilities and improvements	(143,387)	(6,599)	127	(149,859)
Intangible assets	(9,625)	(276)	—	(9,901)
Machinery and equipment	<u>(28,821)</u>	<u>(2,921)</u>	<u>113</u>	<u>(31,629)</u>
Total accumulated depreciation	<u>(181,833)</u>	<u>(9,796)</u>	<u>240</u>	<u>(191,389)</u>
Total capital assets being depreciated, net	<u>166,485</u>	<u>26,005</u>	<u>(78)</u>	<u>192,412</u>
Total capital assets, net	<u>\$ 217,910</u>	<u>65,630</u>	<u>(36,086)</u>	<u>247,454</u>

* Includes \$867 in capital project write-offs primarily related to Hetch Hetchy Power's share of Priest Reservoir Diversion Channel, Reservoir Valve Rehabilitation, and Moccasin Facility Upgrades.

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	<u>Balance June 30, 2010</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance June 30, 2011</u>
Capital assets not being depreciated:				
Land and rights-of-way	\$ 1,662	—	—	1,662
Intangible assets	1,431	—	—	1,431
Construction work in progress	27,083	28,158*	(6,909)	48,332
Total capital assets not being depreciated	<u>30,176</u>	<u>28,158</u>	<u>(6,909)</u>	<u>51,425</u>
Capital assets being depreciated:				
Facilities and improvements	263,648	3,733	(848)	266,533
Intangible assets	25,082	111	—	25,193
Machinery and equipment	52,510	5,343	(1,261)	56,592
Total capital assets being depreciated	<u>341,240</u>	<u>9,187</u>	<u>(2,109)</u>	<u>348,318</u>
Less accumulated depreciation for:				
Facilities and improvements	(136,724)	(6,663)	—	(143,387)
Intangible assets	(9,372)	(253)	—	(9,625)
Machinery and equipment	(26,184)	(2,666)	29	(28,821)
Total accumulated depreciation	<u>(172,280)</u>	<u>(9,582)</u>	<u>29</u>	<u>(181,833)</u>
Total capital assets being depreciated, net	<u>168,960</u>	<u>(395)</u>	<u>(2,080)</u>	<u>166,485</u>
Total capital assets, net	<u>\$ 199,136</u>	<u>27,763</u>	<u>(8,989)</u>	<u>217,910</u>

* Includes a reclassification of \$670 in construction work in progress and \$3,776 in facilities and equipment between Water and Power in fiscal year 2011.

Capital assets with a useful life of 50 years or greater include buildings and structures, reservoirs, dams, power stations, certain water mains and pipelines, transmission and distributions systems, tunnels, and bridges.

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Financial Accounting Standards Board (FASB) Statement 34, *Capitalization of Interest Costs*, requires that interest expense incurred during construction of assets be capitalized. Interest included in the construction work in progress and total interest expense incurred during the years ended June 30, 2012 and 2011 are as follows:

	<u>2012</u>	<u>2011</u>
Interest expensed	\$ 99	562
Interest included in Construction work in progress	1,151	422
Total interest incurred	<u>\$ 1,250</u>	<u>984</u>

During fiscal year 2012, Hetch Hetchy Water and Hetch Hetchy Power expensed \$750 and \$867, respectively, related to capitalized design and planning costs on various Hetch Hetchy projects. Hetch Hetchy Water and Power write-offs of \$1,617 collectively were primarily related to joint projects for Priest Reservoir Diversion Channel, Reservoir Valve Rehabilitation, and Moccasin Facility Upgrades. During fiscal year 2011, Hetch Hetchy Water and Hetch Hetchy Power expensed \$229 and \$1,908, respectively, related to capitalized design and planning costs on certain projects. Hetch Hetchy Power write-offs of \$1,908 were primarily related to Cruise Ship Shore Power and Alternative Transmission projects. Hetch Hetchy Water write-offs of \$229 were primarily related to the Water Maintenance and Moccasin Cottages Repair projects. The amounts of the write-offs were recognized as other operating expenses in the accompanying statements of revenues, expenses, and changes in net assets.

(5) Restricted Assets

Pursuant to the Master Lease/Purchase Agreements (the Agreements), net power revenues of Hetch Hetchy are irrevocably pledged to the punctual payment of debt service on the CREBs, QECBs, and NCREBs. Accordingly, pledged power revenue shall not be used for any other purpose while any of its CREBs, QECBs, and NCREBs are outstanding, except as expressly permitted by the Agreements. Further, all revenues shall be deposited by the City Treasury, by instruction of Hetch Hetchy, in special funds designated as the Hetch Hetchy Water and Power Revenue Fund (the Power Revenue Fund), which must be maintained in the City Treasury. These funds, held at the City Treasury, are recorded in the statements of net assets of Hetch Hetchy as deposits and investments with the City Treasury.

Deposits in the Power Revenue Fund, including earnings thereon, shall be appropriated, transferred, expended, or used for the following purposes pertaining to the financing, maintenance, and operation of Hetch Hetchy in accordance with the following priority:

1. The payment of operation and maintenance expenses for such utility and related facilities;
2. The payment of pension charges and proportionate payments to such compensation and other insurance or outside reserve funds as Hetch Hetchy may establish or the Board of Supervisors may require with respect to employees of Hetch Hetchy;

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3. The payment of principal, interest, reserve, sinking fund, or other mandatory funds created to secure long-term financing issued by Hetch Hetchy for the acquisition, construction, or extension of facilities owned, operated, or controlled by Hetch Hetchy;
4. Reconstruction and replacement as determined by Hetch Hetchy or as required by any of Hetch Hetchy's financing ordinances duly adopted and approved; and
5. The acquisition of land, real property, or interest in real property for, and the acquisition, construction, enlargement, and improvement of, new and existing buildings, structures, facilities, equipment, appliances, and other property necessary or convenient to the development or improvement of such utility owned, controlled, or operated by Hetch Hetchy, and for any other lawful purpose of Hetch Hetchy, including the transfer of surplus funds pursuant to Section 6.407(e) of the City's Charter.

In accordance with the Agreements, Hetch Hetchy maintains certain restricted cash and investment balances in trust. Restricted assets held in trust consist of the following as of June 30, 2012 and 2011:

(a) ***Hetch Hetchy Water***

Hetch Hetchy Water did not have any restricted assets held in trust as of June 30, 2012 and 2011.

(b) ***Hetch Hetchy Power***

Hetch Hetchy Power has the following restricted assets held in trust as of June 30, 2012 and 2011:

	<u>2012</u>	<u>2011</u>
Restricted cash and investments outside City Treasury:		
2008 Clean Renewable Energy Bonds	\$ 1,484	2,589
Certificates of participation – 525 Golden Gate Headquarters	1,593	9,603
Qualified Energy Conservation Bonds	175	—
	<u>\$ 3,252</u>	<u>12,192</u>

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(6) Changes in Long-Term Liabilities

Total Hetch Hetchy Water and Power long-term liability activities for the years ended June 30, 2012 and 2011 are as follows:

	Coupon interest rate*	Final maturity date	July 1, 2011	Additions	Reductions	June 30, 2012	Due within one year
Clean Renewable Energy Bonds	0%	2022	\$ 5,059	—	(422)	4,637	422
Less bond discount			(157)	—	13	(144)	—
Certificates of participation Series 2009C	2.00 to 5.00%	2023	3,705	—	—	3,705	268
Add bond premium			327	—	(54)	273	—
Certificates of participation Series 2009D (BABs)	6.36 to 6.49%	2042	12,593	—	—	12,593	—
Qualified Energy Conservation Bonds	4.74%	2028	—	8,291	—	8,291	443
New Clean Renewable Energy Bonds	4.74%	2028	—	6,600	—	6,600	144
			<u>21,527</u>	<u>14,891</u>	<u>(463)</u>	<u>35,955</u>	<u>1,277</u>
Total revenue bonds and certificates of participation payable							
Other post-employment benefits obligation			11,221	4,550	(1,469)	14,302	—
Accrued vacation and sick leave			2,590	2,225	(1,731)	3,084	1,634
Accrued workers' compensation			2,063	1,041	(783)	2,321	433
Damage claims liability			2,130	2,321	(1,780)	2,671	529
Pollution remediation obligation			1,340	—	(308)	1,032	—
			<u>1,340</u>	<u>—</u>	<u>(308)</u>	<u>1,032</u>	<u>—</u>
Total			<u>\$ 40,871</u>	<u>25,028</u>	<u>(6,534)</u>	<u>59,365</u>	<u>3,873</u>

* After adjusting for the Federal interest subsidy, the true interest cost for the certificates of participation Series 2009D issued as Build America Bonds is 4.3%, 1.2% for the QECBs, and 1.5% for the NCREBs, respectively.

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(Dollars in thousands, unless otherwise stated)

	Coupon interest rate*	Final maturity date	July 1, 2010	Additions	Reductions	June 30, 2011	Due within one year
Clean Renewable Energy Bonds	0%	2022	\$ 5,481	—	(422)	5,059	422
Less bond discount			(171)	—	14	(157)	—
Certificates of participation Series 2009C	2.00 to 5.00%	2023	3,705	—	—	3,705	—
Add bond premium			378	—	(51)	327	—
Certificates of participation Series 2009D (BABs)	6.36 to 6.49%	2042	12,593	—	—	12,593	—
Total revenue bonds and certificates of participation payable			21,986	—	(459)	21,527	422
Other post-employment benefits obligation			8,472	4,184	(1,435)	11,221	—
Accrued vacation and sick leave			2,579	1,383	(1,372)	2,590	1,452
Accrued workers' compensation			2,068	801	(806)	2,063	358
Damage claims liability			1,871	1,623	(1,364)	2,130	418
Pollution remediation obligation			—	1,340	—	1,340	—
Total			\$ 36,976	9,331	(5,436)	40,871	2,650

* After adjusting for the Federal interest subsidy, the true interest cost for the certificates of participation Series 2009D issued as Build America Bonds is 4.3%.

a) Hetch Hetchy Water's long-term liability activities for the years ended June 30, 2012 and 2011 are as follows:

	July 1, 2011	Additions	Reductions	June 30, 2012	Due within one year
Other post-employment benefits obligation	\$ 3,669	2,047	(661)	5,055	—
Accrued vacation and sick leave	740	789	(567)	962	518
Accrued workers' compensation	591	443	(327)	707	133
Damage claims liability	68	694	(467)	295	65
Pollution remediation obligation	1,340	—	(308)	1,032	—
Total	\$ 6,408	3,973	(2,330)	8,051	716

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	<u>July 1, 2010</u>	<u>Additions</u>	<u>Reductions</u>	<u>June 30, 2011</u>	<u>Due within one year</u>
Other post-employment benefits obligation	\$ 2,431	1,884	(646)	3,669	—
Accrued vacation and sick leave	740	366	(366)	740	436
Accrued workers' compensation	593	323	(325)	591	99
Damage claims liability	107	282	(321)	68	15
Pollution remediation obligation	—	1,340	—	1,340	—
Total	<u>\$ 3,871</u>	<u>4,195</u>	<u>(1,658)</u>	<u>6,408</u>	<u>550</u>

- b) Hetch Hetchy Power's long-term liability activities for the years ended June 30, 2012 and 2011 are as follows:

	<u>July 1, 2011</u>	<u>Additions</u>	<u>Reductions</u>	<u>June 30, 2012</u>	<u>Due within one year</u>
Clean Renewable Energy Bonds	\$ 5,059	—	(422)	4,637	422
Less bond discount	(157)	—	13	(144)	—
Certificates of participation					
Series 2009C	3,705	—	—	3,705	268
Add bond premium	327	—	(54)	273	—
Certificates of participation					
Series 2009D (BABs)	12,593	—	—	12,593	—
Qualified Energy Conservation Bonds	—	8,291	—	8,291	443
New Clean Renewable Energy Bonds	—	6,600	—	6,600	144
Total revenue bonds and certificates of participation payable	<u>21,527</u>	<u>14,891</u>	<u>(463)</u>	<u>35,955</u>	<u>1,277</u>
Other post-employment benefits obligation	7,552	2,503	(808)	9,247	—
Accrued vacation and sick leave	1,850	1,436	(1,164)	2,122	1,116
Accrued workers' compensation	1,472	598	(456)	1,614	300
Damage claims liability	2,062	1,627	(1,313)	2,376	464
Total	<u>\$ 34,463</u>	<u>21,055</u>	<u>(4,204)</u>	<u>51,314</u>	<u>3,157</u>

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	<u>July 1, 2010</u>	<u>Additions</u>	<u>Reductions</u>	<u>June 30, 2011</u>	<u>Due within one year</u>
Clean Renewable Energy Bonds \$	5,481	—	(422)	5,059	422
Less bond discount	(171)	—	14	(157)	—
Certificates of participation					
Series 2009C	3,705	—	—	3,705	—
Add bond premium	378	—	(51)	327	—
Certificates of participation					
Series 2009D (BABs)	<u>12,593</u>	<u>—</u>	<u>—</u>	<u>12,593</u>	<u>—</u>
Total revenue bonds and certificates of participation payable	21,986	—	(459)	21,527	422
Other post-employment benefits obligation	6,041	2,300	(789)	7,552	—
Accrued vacation and sick leave	1,839	1,017	(1,006)	1,850	1,016
Accrued workers' compensation	1,475	478	(481)	1,472	259
Damage claims liability	<u>1,764</u>	<u>1,341</u>	<u>(1,043)</u>	<u>2,062</u>	<u>403</u>
Total	<u>\$ 33,105</u>	<u>5,136</u>	<u>(3,778)</u>	<u>34,463</u>	<u>2,100</u>

(a) Clean Renewable Energy Bonds

Hetch Hetchy Power issued \$6,325 in CREBs on November 7, 2008 to finance the installation of solar energy equipment on City-owned facilities, including Chinatown Branch Library, Maxine Hall Medical Center, City Distribution Division Warehouse, North Point Wastewater, Chinatown Public Health Center, Municipal Transportation Agency Woods Facility, and Solar Energy Facility. Hetch Hetchy Power has not previously issued debt and has instead up to this point relied on revenue from ratepayers to fund renewable energy projects. CREBs provide the Commission with low-cost access to capital to further its green power objectives.

Hetch Hetchy Power began making principal payments in the amount of \$422 on December 15, 2008 and will continue annual payments for fifteen years until December 15, 2022. Funding for these payments will be guaranteed by net power revenues. Interest payments are not required, since the effective equivalent of interest on the bonds is paid in the form of Federal tax credits in lieu of interest paid by the issuer.

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The future annual debt service relating to the CREBs outstanding as of June 30, 2012 is as follows:

Hetch Hetchy Power – Clean Renewable Energy Bonds

	<u>Principal</u>
Fiscal years ending June 30:	
2013	\$ 422
2014	422
2015	422
2016	422
2017	422
2018 – 2022	2,110
2023	<u>417</u>
Total	4,637
Less current portion	(422)
Less unamortized bond discount	<u>(144)</u>
Long-term portion as of June 30, 2012	<u>\$ 4,071</u>

(b) *Qualified Energy Conservation Bonds*

In October 2011, Hetch Hetchy Power issued \$8,291 of taxable Qualified Energy Conservation Bonds (QECBs). The QECBs were issued to fund certain qualified green components for the Commission's 525 Golden Gate Headquarters project. The QECBs were nonrated and privately placed with Bank of America Leasing. The net effective interest rate on the QECBs, after the federal tax subsidy, is 1.2% through 2028.

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(Dollars in thousands, unless otherwise stated)

The future annual debt service relating to the QECBs outstanding as of June 30, 2012 is as follows:

Hetch Hetchy Power – Qualified Energy Conservation Bonds

	<u>Principal</u>	<u>Interest before subsidy</u>	<u>Federal interest subsidy</u>	<u>Interest net of subsidy</u>
Fiscal years ending June 30:				
2013	\$ 443	585	(437)	148
2014	499	366	(274)	92
2015	505	342	(256)	86
2016	511	318	(238)	80
2017	517	294	(220)	74
2018 – 2022	2,679	1,096	(819)	277
2023 – 2027	2,844	444	(332)	112
2028	293	7	(4)	3
Total	<u>8,291</u>	<u>3,452</u>	<u>(2,580)</u>	<u>872</u>
Less current portion	<u>(443)</u>			
Long-term portion as of June 30, 2012	\$ <u>7,848</u>			

(c) New Clean Renewable Energy Bonds

In April 2012, Hetch Hetchy Power issued \$6,600 of new taxable New Clean Renewable Energy Bonds (NCREBs). The NCREBs were issued to fund certain qualified facilities that will provide clean, renewable energy at Davies Symphony Hall, City Hall, and University Mount Reservoir. The NCREBs were nonrated and privately placed with Bank of America Leasing. The net effective interest rate on the NCREBs, after the federal tax subsidy, is 1.5% through 2028.

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The future annual debt service relating to the NCERBs outstanding as of June 30, 2012 is as follows:

Hetch Hetchy Power – New Clean Renewable Energy Bonds

	<u>Principal</u>	<u>Interest before subsidy</u>	<u>Federal interest subsidy</u>	<u>Interest net of subsidy</u>
Fiscal years ending June 30:				
2013	\$ 144	313	(217)	96
2014	388	301	(209)	92
2015	394	283	(196)	87
2016	399	264	(183)	81
2017	405	245	(170)	75
2018 – 2022	2,117	931	(644)	287
2023 – 2027	2,277	413	(285)	128
2028	<u>476</u>	<u>18</u>	<u>(13)</u>	<u>5</u>
Total	6,600	<u>2,768</u>	<u>(1,917)</u>	<u>851</u>
Less current portion	<u>(144)</u>			
Long-term portion as of June 30, 2012	\$ <u>6,456</u>			

(d) Certificates of Participation Issued for the 525 Golden Gate Headquarters Project

In October 2009, the City & County of San Francisco issued \$167,670 in certificates of participation to fund construction of the future headquarters of the San Francisco Public Utilities Commission (SFPUC) at 525 Golden Gate Avenue. The 2009 Series C certificates were issued for \$38,120 and 2009 Series D for \$129,550 as “Build America Bonds” (BABs) on a taxable basis under the 2009 American Recovery and Reinvestment Act. The 2009 Series C certificates carry interest rates ranging from 2.0% to 5.0% and mature on November 1, 2022. The 2009 Series D certificates carry interest rates ranging from 6.4% to 6.5% and mature on November 1, 2041. After adjusting Series D for the Federal interest subsidy, the true interest cost averages 3.4% and 4.3% for Series C and Series D certificates, respectively.

Under the terms of a Memorandum of Understanding between the City and the SFPUC dated October 1, 2009, the City conveyed the real property to the Trustee, the Bank of New York Mellon Trust Company, N.A., under a property lease in exchange for the proceeds of the sale of the certificates. The Trustee has leased the property back to the City for the City’s use under a Project Lease. The City will be obligated under the Project Lease to pay base rental payments and other payments to the Trustee each year during the thirty-two year term of the Project Lease. The Commission will make annual base rental payments to the City for the building equal to annual debt service on the certificates. It is anticipated that these lease costs will be offset with reductions in costs associated with current office rental expense.

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Hetch Hetchy, Water and Wastewater enterprises have ownership interest in the building equal to their projected usage of space as follows: Water (73%), Wastewater (15%) and Power (12%). Similarly, each Enterprise is responsible for a portion of the annual Base Rental Payment based on their ownership percentages less contributed equity. The percentage share of Base Rental Payments for the Enterprises is as follows: Water (71.4%), Wastewater (18.9%), and Power (9.7%).

The future annual debt service relating to the certificates of participation Series 2009C outstanding as of June 30, 2012 is as follows:

Hetch Hetchy Power – Certificates of Participation Series 2009C (Tax Exempt)

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Fiscal years ending June 30:			
2013	\$ 268	168	436
2014	277	158	435
2015	287	149	436
2016	299	136	435
2017	315	121	436
2018 – 2022	1,834	344	2,178
2023	425	11	436
Total	<u>3,705</u>	<u>1,087</u>	<u>4,792</u>
Less current portion	(268)		
Add unamortized bond premium	<u>273</u>		
Long-term portion as of June 30, 2012	<u>\$ 3,710</u>		

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The following table presents the future annual debt service relating to the certificates of participation Series 2009D outstanding as of June 30, 2012. The Federal interest subsidy represents 35% of the interest:

Hetch Hetchy Power – Certificates of Participation Series 2009D (Taxable BABs)

	Principal	Interest before subsidy	Federal interest subsidy	Interest net of subsidy
Fiscal years ending June 30:				
2013	\$ —	812	(284)	528
2014	—	812	(284)	528
2015	—	812	(284)	528
2016	—	812	(284)	528
2017	—	812	(284)	528
2018 – 2022	—	4,064	(1,423)	2,641
2023 – 2027	1,894	3,828	(1,340)	2,488
2028 – 2032	2,852	3,019	(1,056)	1,963
2033 – 2037	3,514	1,994	(698)	1,296
2038 – 2042	4,333	728	(255)	473
Long-term portion as of June 30, 2012	\$ 12,593	17,693	(6,192)	11,501

(7) Revenue Pledge

Hetch Hetchy Power has pledged future power revenues to repay Qualified Energy Conservation Bonds (QECBs), and New Clean Renewable Energy Bonds (NCREBs) which were issued in fiscal year 2012. Additionally, Hetch Hetchy Power has pledged future power revenues for Clean Renewable Energy Bonds (CREBs) which were issued in fiscal year 2009. Proceeds from the bonds provided financing for various capital construction and facility energy efficiency projects. The bonds are payable solely from net power revenues of Hetch Hetchy Power and are payable through the year ending June 30, 2028.

The original amount of revenue bonds issued, total principal and interest remaining, principal paid during fiscal year 2012, and applicable revenues for fiscal year 2012 are as follows:

Hetch Hetchy Power

	2012	2011
Bonds issued with revenue pledge	\$ 21,216	6,325
Principal and interest remaining due at the end of the year	25,748	5,059
Principal and interest paid during the year	422	422
Funds available for revenue bond debt service	20,551	41,773

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(8) Other Revenue – Trans Bay Cable Construction and Licensing Fees

On August 7, 2007, the Board of Supervisors adopted Resolution No. 070315, two nonexclusive licenses to the Trans Bay Cable LLC (the Licensee) for the “Trans Bay Cable Project”. The Licensee proposed to install, operate and maintain approximately 53 miles of high voltage direct current transmission cable bundle of approximately 10 inches in diameter running from the City of Pittsburg to the City of San Francisco. Approximately 9.4 miles of the cable are in submerged lands, a small portion of shoreline, and on a portion of a street that are under San Francisco Port Commission jurisdiction (the License Area).

The first license is a Construction License, San Francisco Port Commission License No. 14324, a nonexclusive license to install a 400 MW high voltage transmission line, with a four (4) year term. The “Licensee” will pay the Port of San Francisco under this license, and has paid Hetch Hetchy Power \$3,500 in 36 monthly installments of \$97 as the “Renewable Energy, Transmission and Grid Reliability Payment.” By June 30, 2010, SFPUC recorded total collections of \$3,500. Per the License agreement, the SFPUC shall use the payments for study and development of two City-owned transmission projects, a Newark-San Francisco Project and a Potrero-Embarcadero Project. For fiscal years ended June 30, 2012 and June 30, 2011 expenses were \$836 and \$405, respectively.

The second license is an Operational License, San Francisco Port Commission License No. 14325, a nonexclusive license for operation of the transmission line with twenty-five (25) year term with an option to renew for ten (10) years. The “Licensee” will pay Hetch Hetchy Power in excess of \$20,000 in 10 separate installments of \$2,000 annually with adjustments for inflation, as the “San Francisco Electric Reliability Payment” to implement, advance, promote or enhance policies and projects consistent with City Energy Policies. The project came on line November 29, 2010, and Hetch Hetchy Power received the first installment of \$2,000. For fiscal years ended June 30, 2012 and 2011, \$2,057 and \$2,000 of revenue have been recorded, respectively. Per the License agreement, the SFPUC shall consult with Departments of Environment and Public Health, as well as community members, including the Power Plant Task Force, in developing its proposals to the Board of Supervisors for how to spend the San Francisco Electricity Reliability Payment, and shall consider specifically renewable energy, conservation, and environmental health programs which benefit low income, at-risk, and environmentally disadvantaged communities. The San Francisco Electricity Reliability Payment shall also be partly used for green jobs training and placement programs which benefit low income, at-risk, and environmentally disadvantaged communities. During the fiscal year ended June 30, 2012 the Board of Supervisors released the funds in reserve for the San Francisco Electricity Reliability Payment.

(9) Employee Benefits

(a) Retirement Plan

Plan Description – Hetch Hetchy participates in the City’s single-employer defined benefit retirement plan (the Plan), which is administered by the San Francisco City and County Employees’ Retirement System (the Retirement System). The Plan covers substantially all full-time employees of Hetch Hetchy along with other employees of the City. The Plan provides basic service retirement, disability, and death benefits based on specified percentages of final average salary and provides cost-of-living adjustments after retirement. The Plan also provides pension continuation benefits to

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qualified survivors. The San Francisco City and County Charter and Administrative Code are the authority which establishes and amends the benefit provisions and employer obligations of the Plan.

Funding Policy – Contributions to the basic Plan are made by both Hetch Hetchy and its employees. Employee contributions are mandatory. Employee contribution rates for fiscal years 2012, 2011, and 2010 varied from 7.5% to 8.0% as a percentage of covered payrolls. In addition, Hetch Hetchy was required to contribute for the fiscal years ended June 30, 2012, 2011, and 2010, at an actuarially determined contribution rate as a percentage of covered payrolls of 18.1%, 13.6%, and 9.5%, respectively. Hetch Hetchy contributed 100% of its required contribution of \$4,540 in 2012, \$3,252 in 2011, and \$2,417 in 2010. Hetch Hetchy Water's share of the contribution for the fiscal year 2012 was \$2,043 or 45% and Hetch Hetchy Power's share of the contribution was \$2,497 or 55%.

Proposition B, a City Charter Amendment Changing Qualifications for Retiree Health and Pension Benefits and Establishing a Retiree Health Care Trust Fund, was passed by voters on June 3, 2008, and increased the years of service required to qualify for employer-funded retiree health benefits for City employees who retire under the San Francisco Employees Retirement System and were hired on or after January 10, 2009. Employees hired before January 10, 2009, became eligible to participate in the retirement health care system after 5 years of service and the employer paid 100% of the contribution. Proposition B also stated that a separate Retiree Health Care Trust Fund would be created to pay for the City's future costs related to retiree health care. This trust fund will be funded by employer and employee contributions for employees hired on or after January 10, 2009. These new employees would contribute up to 2% of their pre-tax pay and employers would contribute 1%.

The Retirement System issues a publicly available financial report for City-wide level that includes financial statements and required supplementary information for the Plan. That report may be obtained by writing to the San Francisco City and County Employees' Retirement System, 30 Van Ness Avenue, Suite 3000, San Francisco, CA 94102, or by calling (415) 487-7020.

(b) Health Care Benefits

Health care benefits of Hetch Hetchy employees, retired employees and surviving spouses are financed by beneficiaries and by the City through the City and County of San Francisco Health Service System (the Health Service System). Hetch Hetchy's annual contribution, which amounted to approximately \$5,549 and \$5,079 in fiscal years 2012 and 2011, respectively, is determined by a San Francisco Charter provision based on similar contributions made by the 10 most populous counties in California.

Included in these amounts are \$1,469 and \$1,435 for 2012 and 2011, respectively, to provide post-retirement benefits for retired employees, on a pay-as-you-go basis. There was no City allocation to the Enterprise's contribution for payments made from the Health Services System for post-retirement health benefits in 2012 and 2011.

The City has determined a City-wide Annual Required Contribution (ARC), interest on net other post-employment benefits other than pensions (OPEB) obligation, ARC adjustment, and OPEB cost based upon an actuarial valuation performed in accordance with GASB 45, by the City's actuaries.

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The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover the normal cost of each year and any unfunded actuarial liabilities (or funding excess) amortized over thirty years. The City's allocation of the OPEB related costs to Hetch Hetchy for the year ended June 30, 2012 based upon its percentage of City-wide payroll costs is presented below.

The following table shows the components of the City's annual OPEB allocations for Hetch Hetchy for the years ended June 30, 2012 and 2011, for the amount contributed to the plan, and changes in the City's net OPEB obligation:

	Hetch Hetchy Water	Hetch Hetchy Power	Total 2012 Hetch Hetchy Water & Power
	<hr/>	<hr/>	<hr/>
Annual required contribution	\$ 2,007	2,454	4,461
Interest on net OPEB obligation	235	288	523
Adjustment to ARC	<hr/> (195)	<hr/> (239)	<hr/> (434)
Annual OPEB cost (expense)	2,047	2,503	4,550
Contribution made	<hr/> (661)	<hr/> (808)	<hr/> (1,469)
Increase in net OPEB obligation	1,386	1,695	3,081
Net OPEB obligation – beginning of year	<hr/> 3,669	<hr/> 7,552	<hr/> 11,221
Net OPEB obligation – end of year	\$ <hr/> <hr/> 5,055	<hr/> <hr/> 9,247	<hr/> <hr/> 14,302

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(Dollars in thousands, unless otherwise stated)

		Hetch Hetchy Water	Hetch Hetchy Power	Total 2011 Hetch Hetchy Water & Power
		<hr/>	<hr/>	<hr/>
Annual required contribution	\$	1,846	2,254	4,100
Interest on net OPEB obligation		174	213	387
Adjustment to ARC		(136)	(167)	(303)
		<hr/>	<hr/>	<hr/>
Annual OPEB cost (expense)		1,884	2,300	4,184
Contribution made		(646)	(789)	(1,435)
		<hr/>	<hr/>	<hr/>
Increase in net OPEB obligation		1,238	1,511	2,749
Net OPEB obligation – beginning of year		2,431	6,041	8,472
Net OPEB obligation – end of year	\$	<u>3,669</u>	<u>7,552</u>	<u>11,221</u>

The City issues a publicly available financial report for City-wide level that includes the complete note disclosures and required supplementary information related to the City's post-retirement health care obligations. The report may be obtained by writing to the City and County of San Francisco, Office of the Controller, 1 Dr. Carlton B. Goodlett Place, Room 316, San Francisco, CA 94102, or by calling (415) 554-7500.

(10) Related Parties

(a) *Hetch Hetchy Water and Power*

Various common costs incurred by the Commission are allocated pro-ratably among Hetch Hetchy, the Water Enterprise, and the Wastewater Enterprise. The allocations are based on the Commission management's best estimate and may change from year to year depending on the activities incurred by each department and the information available. For the years ended June 30, 2012 and 2011, the Commission allocated \$10,078 and \$9,803, respectively, in administrative costs to Hetch Hetchy, which is included in the financial statements under various expense categories. These costs are then allocated to Hetch Hetchy Water and Hetch Hetchy Power in the Hetch Hetchy financial statements, using the periodically reviewed department overhead allocation model.

The City performs certain administrative services such as maintenance of accounting records and investment of cash for all fund groups within the City. The various funds are charged for these services based on the City's indirect cost allocation plan. The overhead allocation paid to the General Fund of the City by Hetch Hetchy was \$2,410 and \$404 for the years ended June 30, 2012 and 2011, respectively, and is included in other operating expenses in the accompanying financial statements.

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A variety of City departments provide direct services such as engineering, purchasing, legal, data processing, telecommunication, and human resources to Hetch Hetchy and charge amounts designed to recover those departments' costs. These charges totaling approximately \$5,825 and \$5,425 for the years ended June 30, 2012 and 2011, respectively, have been included in services provided by other departments in the accompanying financial statements.

SFPUC entered into a seventy-five year lease agreement with the San Francisco Recreation and Park Commission for the use of parking spaces at the parking garage located at 355 McAllister Street beneath Civic Center Plaza which is in closer proximity to SFPUC's new headquarters at 525 Golden Gate Avenue. The term of the agreement commenced on February 1, 2011, with 40 parking spaces allocated to SFPUC. As of April 1, 2012, SFPUC had the rights to an additional 20 parking spaces. As of June 30, 2012, SFPUC exercised four of the additional 20 parking spaces for a total of 44 parking spaces. The total payment under this agreement is \$6,274 and the first payment in the amount of \$1,500 was made in the fiscal year 2011. Of this \$1,500, SFPUC recognized \$40 as expenses for the 40 parking spaces rented between February and June, 2011. The remaining \$1,460 was recorded as prepaid. Of the second payment in the amount of \$1,500 made in the fiscal year ending June 30, 2012, SFPUC recognized \$84 as expenses and the remaining \$1,416 was recorded as prepaid. The expenses and prepayment were prorated and allocated among the three SFPUC Enterprises based on the use of parking spaces. The total remaining payments that will be allocated to the 3 enterprises will be made as follows:

	<u>Amount</u>
Fiscal years ending June 30:	
2013	\$ 1,500
2014	1,500
2015	<u>274</u>
Total	<u>\$ 3,274</u>

In fiscal year 2012, Hetch Hetchy Water and Hetch Hetchy Power Enterprise's allocable share of expenses and prepayment was \$2 and \$2,087, respectively. Hetch Hetchy Water and Hetch Hetchy Power incurred \$1 and \$1 of expenses, and prepayment was \$10 and \$1,055, respectively. In fiscal year 2011, Hetch Hetchy Power did not incur any expense and its allocable share of prepayment was \$1,022.

(b) Hetch Hetchy Water

The Water Enterprise purchases water from Hetch Hetchy Water. Included in the operating revenues are the water assessment fees of \$30,639 and \$29,747 for the years ended June 30, 2012 and 2011, respectively.

During the fiscal year ending June 30, 2012, \$14,073 was transferred in from the Water Enterprise to finance improvements of certain up-country water storage and transmission facilities.

HETCH HETCHY WATER AND POWER

Notes to Financial Statements

June 30, 2012 and 2011

(Dollars in thousands, unless otherwise stated)

(c) ***Hetch Hetchy Power***

During 2012 and 2011, Hetch Hetchy Power delivered power and gas without charge to certain City departments, which amounted to \$2,612 and \$2,630, respectively, based on metered usage and what would otherwise be the applicable power rates. These amounts were excluded from operating revenues in the accompanying financial statements.

Included in 2012 and 2011 operating revenues are sales of power to departments within the City of \$62,671 and \$62,336, respectively, excluding free power noted above.

The Water Enterprise also purchases electricity from Hetch Hetchy Power. This amount totaled \$7,175 and \$6,591 for the years ended June 30, 2012 and 2011, respectively.

The Wastewater Enterprise purchases electricity from Hetch Hetchy Power. This amount totaled \$8,618 and \$8,959 for the years ended June 30, 2012 and 2011, respectively.

Hetch Hetchy Power facilitates all electric and gas service connections between Pacific Gas and Electric Company (PG&E) and City departments. In this capacity, Hetch Hetchy Power facilitates and coordinates the terms and payment for the service connections that are performed by PG&E. As of June 30, 2012 and 2011, there were no outstanding amounts due from City departments related to this work. In the event Hetch Hetchy Power received money from PG&E after project completion, monies are to be refunded back to the City departments for their respective credits.

Hetch Hetchy Power serves as the City's agency for energy efficiency projects and maintains the Sustainable Energy Account (SEA) (formerly known as the Mayor's Energy Conservation Account) fund to sponsor and financially support such projects at various City departments. In this role, Hetch Hetchy Power may secure low-interest financing to supplement funds available in the SEA fund. At June 30, 2012 and 2011, projects completed or underway throughout the City amounted to \$12,048 and \$13,241, respectively, and are recorded as due from other governmental agencies.

Besides funding the SEA projects, in fiscal year 2010 Hetch Hetchy funded a project for the Treasure Island Development Authority and recorded \$2,599 as due from other governmental agencies. Hetch Hetchy Power and the Moscone Center have renegotiated the memoranda of understanding to extend the payment terms of the receivables to match the useful life of underlying assets.

As of June 30, 2012, Hetch Hetchy Power has receivables from the Water and Wastewater Enterprises for their share of costs relating to 525 Golden Gate Headquarters project for information technology and living machine equipment. Hetch Hetchy Power has a payable in the amount of \$214 due to the Water Enterprise for its allocable share of costs associated with 525 Golden Gate Headquarters project construction costs.

HETCH HETCHY WATER AND POWER

Notes to Financial Statements

June 30, 2012 and 2011

(Dollars in thousands, unless otherwise stated)

Details of these projects are as follows:

	<u>2012</u>	<u>2011</u>
Moscone Center	\$ 9,112	9,619
San Francisco General Hospital	1,440	1,670
San Francisco Department of Public Health	615	750
Port of San Francisco	316	511
Wastewater	<u>565</u>	<u>691</u>
Total SEA related projects	12,048	13,241
Treasure Island Development Authority	2,599	2,599
Water – 525 Golden Gate Avenue Headquarters Project	2,394	—
Wastewater – 525 Golden Gate Avenue Headquarters Project	<u>2,225</u>	<u>—</u>
Total due from other City departments	19,266	15,840
Less current portion	<u>(2,207)</u>	<u>(1,178)</u>
Long-term portion as of June 30	<u>\$ 17,059</u>	<u>14,662</u>

HETCH HETCHY WATER AND POWER

Notes to Financial Statements

June 30, 2012 and 2011

(Dollars in thousands, unless otherwise stated)

(11) Risk Management

The Enterprise’s risk management program includes both self-insured and insured exposures at risk. Risk assessments and purchasing of insurance coverage are collaboratively coordinated by SFPUC Enterprise Risk Management and the City’s Office of Risk Management. With certain exceptions, the City and the Enterprise’s general policy is to first evaluate the exposure at risk for self-insurance. Based on this analysis, internal mitigation strategies and financing through a ‘self-retention’ mechanism is generally more economical as the SFPUC administers, adjusts, settles, defends, and pays claims from budgeted resources (i.e. pay-as-you-go fund). When economically more viable or when required by debt financing covenants, the Enterprise obtains commercial insurance. At least annually, the City actuarially determines general liability and workers’ compensation risk exposures. The Enterprise does not maintain commercial earthquake coverage, with certain minor exceptions, such as a sub-limit for fire-sprinkler leakage due to earthquake under the Property Insurance program.

<u>Primary risks</u>	<u>Typical coverage approach</u>
General liability	Self-Insured
Property	Purchase Insurance and Self-Insured
Workers’ compensation	Self-Insured through Citywide Pool
<u>Other risks</u>	<u>Typical coverage approach</u>
Surety bonds	Purchased and Contractually Transferred
Professional liability	Combination of Self-Insured, Purchased Insurance and Contractual Risk Transfer
Errors and omissions	Combination of Self-Insured, Purchased Insurance and Contractual Risk Transfer
Builders’ risk	Purchased Insurance and Contractual Risk Transfer
Public Officials Liability	Purchased Insurance

(a) *Damage Claims Liability*

Through coordination with the Controller and the City Attorney’s Office, the general liability risk exposure is actuarially determined and is addressed through pay-as-you-go funding as part of the budgetary process. Associated costs are also booked as expenses as required under Generally Accepted Accounting Principles (GAAP) for financial statement purposes for both the Enterprise and the City and County of San Francisco’s Comprehensive Annual Financial Report (CAFR). The claim expense allocations are determined based on actuarially determined anticipated claim payments and the projected timing of disbursement.

HETCH HETCHY WATER AND POWER

Notes to Financial Statements

June 30, 2012 and 2011

(Dollars in thousands, unless otherwise stated)

Hetch Hetchy Water and Power

Hetch Hetchy Water and Power's damage claims liability changes for the years ended June 30, 2012 and 2011 are as follows:

	<u>Beginning of year</u>	<u>Claims and changes in estimates</u>	<u>Claims paid</u>	<u>End of year</u>
2010 – 2011	\$ 1,871	1,623	(1,364)	2,130
2011 – 2012	2,130	2,321	(1,780)	2,671

Hetch Hetchy Water

The changes for the damage claims liability for the years ended June 30, 2012 and 2011 are as follows:

	<u>Beginning of year</u>	<u>Claims and changes in estimates</u>	<u>Claims paid</u>	<u>End of year</u>
2010 – 2011	\$ 107	282	(321)	68
2011 – 2012	68	694	(467)	295

Hetch Hetchy Power

The changes for the damage claims liability for the years ended June 30, 2012 and 2011 are as follows:

	<u>Beginning of year</u>	<u>Claims and changes in estimates</u>	<u>Claims paid</u>	<u>End of year</u>
2010 – 2011	\$ 1,764	1,341	(1,043)	2,062
2011 – 2012	2,062	1,627	(1,313)	2,376

(b) **Property**

The Enterprise's property risk management approach varies depending on whether the facility is currently under construction, or if the property is part of revenue-generating operations. For new construction projects, the Enterprise has utilized traditional insurance or other alternative insurance programs. Under the latter approach, the insurance program usually provides coverage for the entire construction project, along with multiple risk coverages, such as for general liability, property damage and workers' compensation, for example. When a traditional insurance program is used for property risks, the Enterprise requires each contractor to provide its own insurance, while ensuring that the full scope of work be covered with satisfactory levels to limit the Enterprise's risk exposure.

HETCH HETCHY WATER AND POWER

Notes to Financial Statements

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(Dollars in thousands, unless otherwise stated)

The majority of purchased insurance program is for either: 1) revenue-generating facilities, 2) debt-financed facilities, or 3) mandated coverage to meet statutory requirements for bonding of various public officials.

(c) **Workers' Compensation**

The City actuarially determines and allocates workers' compensation costs to the Enterprise according to a formula based on the following: (i) the dollar amount of claims; (ii) yearly projections of payments based on historical experience; and (iii) the size of the Enterprise's payroll. The administration of workers' compensation claims and payouts are handled by the Workers' Compensation Division of the City's Department of Human Resources. Statewide workers' compensation reforms have resulted in budgetary savings in recent years. The City continues to develop and implement improved programs, such as return-to-work programs, to lower or mitigate the growth of workers' compensation costs. Programs include: accident prevention, investigation and duty modification for injured employees with medical restrictions so return to work can occur as soon as possible.

Hetch Hetchy Water and Power

The changes for the workers' compensation liabilities for the years ended June 30, 2012 and 2011 are as follows:

	<u>Beginning of year</u>	<u>Claims and changes in estimates</u>	<u>Claims paid</u>	<u>End of year</u>
2010 – 2011	\$ 2,068	801	(806)	2,063
2011 – 2012	2,063	1,041	(783)	2,321

Hetch Hetchy Water

The changes for the workers' compensation liabilities for the years ended June 30, 2012 and 2011 are as follows:

	<u>Beginning of year</u>	<u>Claims and changes in estimates</u>	<u>Claims paid</u>	<u>End of year</u>
2010 – 2011	\$ 593	323	(325)	591
2011 – 2012	591	443	(327)	707

HETCH HETCHY WATER AND POWER

Notes to Financial Statements

June 30, 2012 and 2011

(Dollars in thousands, unless otherwise stated)

Hetch Hetchy Power

The changes for the workers' compensation liabilities for the years ended June 30, 2012 and 2011 are as follows:

	<u>Beginning of year</u>	<u>Claims and changes in estimates</u>	<u>Claims paid</u>	<u>End of year</u>
2010 – 2011	\$ 1,475	478	(481)	1,472
2011 – 2012	1,472	598	(456)	1,614

(d) *Surety Bonds and Public Official Liability*

Bonds are required in most phases of the public utilities construction contracting process for such phases, as bid, performance, and payment or maintenance. Additionally, bonds may be required in other contracts where goods or services are provided to ensure compliance with applicable terms and conditions such as warranty. All SFPUC public officials with financial oversight responsibilities are provided coverage through a commercial Public Official Liability policy.

(e) *Professional Liability, Errors and Omissions*

Professional liability policies are either directly purchased insurance on behalf of the Enterprise, transferred through contract to the contracted professional, or retained through self-insurance on a case by case basis depending on the size, complexity or scope of construction or professional service contracts. Examples of contracts providing any form of the coverages described are engineers, architects, design professionals and other licensed or certified professional service providers.

(f) *Builders' Risk*

Builders' risk policies of insurance are required to be provided by the contractor on all construction projects for the full value of construction.

(12) Commitments and Litigation

(a) *Commitments*

As of June 30, 2012 and 2011, Hetch Hetchy Water and Power has outstanding commitments with third parties of \$31,708 and \$26,896, respectively, for various capital projects and other purchase agreements for materials and services.

Hetch Hetchy Water

To meet certain requirements of the Don Pedro Reservoir operating license, the City entered into an agreement with the Districts in which the Districts would be responsible for an increase in water flow releases from the reservoir in exchange for annual payments from the City, which are included in Hetch Hetchy Water's operating expenses. The payment amounts were \$4,342 and \$4,531 in fiscal years 2012 and 2011, respectively. The payments are to be made for the duration of the license, but

HETCH HETCHY WATER AND POWER

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(Dollars in thousands, unless otherwise stated)

may be terminated with one year's prior written notice after 2001. The City and the Districts have also agreed to monitor the fisheries in the lower Tuolumne River for the duration of the license. A maximum monitoring expense of \$1,400 is to be shared between the City and the Districts over the term of the license. The City's share of the monitoring costs is 52%, while the Districts are responsible for 48% of the costs.

Hetch Hetchy Power

District Sales

In April 1988, Hetch Hetchy Power entered into a long-term power sales agreement (the Agreement) with the Districts. In June 2003, Hetch Hetchy Power amended the terms of the Agreement with the Modesto Irrigation District (MID). Under the terms of the amended and restated long-term power sales agreement, which became effective on January 1, 2003, the expiration date was shortened to December 31, 2007. The Agreement with MID was renegotiated and became effective on January 1, 2008 which removed Hetch Hetchy Power's obligation to provide firm power and eliminated MID's rights to excess energy from the project. This Agreement expires on June 30, 2015. In April 2005, Hetch Hetchy Power amended the terms of the Agreement with Turlock Irrigation District (TID). The settlement agreement between the Commission and TID restates and amends the power sales agreement and terminates Hetch Hetchy Power's obligation to provide TID firm power at below market costs to the end of the agreement's term on June 30, 2015. The Commission will continue to comply with the Raker Act by making Hetch Hetchy generated hydropower available at cost to MID and TID for its agricultural pumping and municipal loads as energy is available. For fiscal years 2012 and 2011, energy sales to the Districts totaled 277,838 MWh or \$7,129 and 459,320 MWh or \$10,788, respectively.

Interconnection Agreement

Effective September 21, 2007, the City renegotiated the Interconnection Agreement with PG&E to provide transmission and distribution services on PG&E's system to deliver Hetch Hetchy's power to its customers. In addition, the Agreement provides supplemental power and energy banking and other support services to Hetch Hetchy Power. The Agreement provides audit rights to review past billings paid by Hetch Hetchy Power and to retroactively (up to two years) adjust these payments as determined necessary. During fiscal years 2012 and 2011, Hetch Hetchy Power purchased \$13,458 and \$13,665, respectively, of transmission, distribution services, and other support services from PG&E under the terms of the Agreement.

The City's Interconnection Agreement with PG&E contains a contractual provision allowing it to bank excess power produced, with a maximum of 110,000 Megawatt hours (MWh). During fiscal year 2012, Hetch Hetchy Power generated 1,321,576 MWh of power, banked (deposited) in the Deferred Delivery Account (DDA) 132,678 MWh and used (withdrew) 110,700 MWh. At June 30, 2012 and 2011, the balance in the bank was 102,305 MWh or \$2,853 and 80,327 MWh or \$2,240, respectively.

HETCH HETCHY WATER AND POWER

Notes to Financial Statements

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(Dollars in thousands, unless otherwise stated)

Western System Power Pool

Hetch Hetchy Power may purchase or sell energy with different market entities through the Western System Power Pool (WSPP). During fiscal year 2012, Hetch Hetchy Power purchased \$3,076 of power. Sales of excess power, after meeting Hetch Hetchy's obligations, were 143,675 MWh, or \$3,817. During fiscal year 2011, Hetch Hetchy Power purchased \$173 of power. Sales of excess power, after meeting Hetch Hetchy's obligations, were 568,157 MWh, or \$16,292.

Power Purchase Agreement

Hetch Hetchy Power (Buyer) entered into a 25-year power purchase agreement (PPA) with Recurrent Energy SFCity1, LP (Seller) to purchase energy generated from a solar photovoltaic project located at Sunset Reservoir in June, 2009, following the board resolution. In accordance with the terms and conditions, commencing on the Actual Commercial Operation Date and continuing throughout the term, Seller shall sell and deliver at the Delivery Point, and Buyer shall purchase and accept from Seller and pay the applicable Contract Price for all of the output. Seller shall only schedule and deliver to Buyer Energy and Environmental Attributes and Capacity Attributes from the Generating Facility. The facility achieved commercial operation in November, 2010 when Hetch Hetchy Power began to purchase energy generated by the facility in fiscal year 2011.

The contract stipulates purchase of energy generated at \$235/Megawatt hours (MWh) which is escalated by 3% each year throughout the term of the agreement. It is expected that the facility will generate 6,560 MWh per year, with the first annual purchase cost of approximately \$1.5 million plus possessory interest tax for the facility, estimated to be \$0.02 million in the first year. In the event that the facility generates more energy than expected due to better than normal meteorological conditions, the contract requires the Buyer to purchase all the excess energy but payment is capped at 20% of the excess energy. This excess 20% energy is approximately \$0.3 million in the first year. The contract also requires the Seller to generate a minimum amount of power and energy from the facility. If the Seller does not generate 50% of the expected energy, the seller must provide replacement power, and if power generation falls below 90% of expectation, then the price that the Buyer pays for the energy generated is lowered.

In fiscal year 2012 and 2011, purchases of energy from Recurrent Energy were \$1,679 or 6,782 MWh, and \$1,060 or 4,252 MWh, respectively.

(b) Energy Risk Management

Hetch Hetchy is exposed to risks that could negatively impact its ability to generate net revenues to fund operating and capital investment activities. Hydroelectric generation facilities in the Sierra Nevada are the primary source of electricity for Hetch Hetchy. For this reason, the financial results of Hetch Hetchy are sensitive to variability in watershed hydrology and market prices for energy.

HETCH HETCHY WATER AND POWER

Notes to Financial Statements

June 30, 2012 and 2011

(Dollars in thousands, unless otherwise stated)

(c) *Litigation*

Hetch Hetchy is a defendant in various legal actions and claims that arise during the normal course of business. The final disposition of these legal actions and claims is not determinable. However, in the opinion of management, the outcome of any litigation of these matters will not have a material effect on the financial position or changes in net assets of Hetch Hetchy.

(13) **Subsequent Events**

(a) *CleanPowerSF*

Culminating an eight-year effort, on September 18, 2012 San Francisco became the second California municipality to approve a city-run program to allow energy ratepayers to purchase green power, creating a community choice aggregation program modeled after Marin County's program, which also contracts with Shell Energy North America to provide renewable power. Such programs were made possible under a 2002 State law that allows municipalities to choose alternative electricity providers. The Board of Supervisors approved the launch of CleanPowerSF on September 25, 2012 that would allocate \$19.5 million to secure a contract with Shell Energy North America to provide 100% renewable power to San Franciscans who want to pay a premium for it, with \$2 million of that total allocated to studying local power-generation options. The CleanPowerSF program is designed to build a customer base and revenue stream to lay the groundwork for city-owned renewable power generation while advancing San Francisco's aggressive greenhouse gas reduction goals.

(b) *AB32 Cap and Trade*

Over the past decade, California has enacted legislation to create several programs to reduce greenhouse gas emissions. Important legislative and regulatory decisions are expected in the near term that could result in income streams for the SFPUC. These include Cap and Trade allowance auction revenues and compliance offset credits; Low Carbon Fuel Standard credits; and the Renewables Portfolio Standard renewable energy credits. In addition to Greenhouse Gas programs that could possibly benefit the SFPUC, there may also be compliance rules that would not be favorable to our operations. The Power Enterprise has been allocated approximately 95,000 emissions allowances for 2012; the Enterprise plans to offer all of its allowances at the Air Resources Board's November 2012 auction. With a floor price of ten dollars per allowance, the Enterprise could realize approximately \$951,000 or close to one million dollars in revenue if all allowances are sold.



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**Report on Internal Control Over Financial Reporting and on Compliance and
Other Matters Based on an Audit of Financial Statements
Performed in Accordance with *Government Auditing Standards***

The Honorable Mayor and Board of Supervisors
City and County of San Francisco, California:

We have audited the financial statements of the business-type activities and each major fund of Hetch Hetchy Water and Power (Hetch Hetchy), an enterprise fund of the City and County of San Francisco, California (the City) as of and for the year ended June 30, 2012, which collectively comprise Hetch Hetchy's basic financial statements and have issued our report thereon dated October 25, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

Management of the Enterprise is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered Hetch Hetchy's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Hetch Hetchy's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Hetch Hetchy's internal control over financial reporting.

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Hetch Hetchy's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The



results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of management, the City and County of San Francisco Government Audit and Oversight Committee, the Commission and others within the entity, and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

October 25, 2012