



**DEPARTMENT OF WATER AND POWER
OF THE CITY OF LOS ANGELES
WATER SYSTEM**

Financial Statements and
Required Supplementary Information

June 30, 2020 and 2019

(With Independent Auditors' Report Thereon)

**DEPARTMENT OF WATER AND POWER
OF THE CITY OF LOS ANGELES
WATER SYSTEM**

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KPMG LLP
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Independent Auditors' Report

The Board of Water and Power Commissioners
City of Los Angeles
Department of Water and Power:

Report on the Financial Statements

We have audited the accompanying financial statements of the Department of Water and Power of the City of Los Angeles Water Revenue Fund (Water System), an enterprise fund of the City of Los Angeles, California, as of and for the years ended June 30, 2020 and 2019, and the related notes to the financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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 from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Department of Water and Power of the City of Los Angeles Water Revenue Fund as of June 30, 2020 and 2019, and the changes in its net position and its cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.



Emphasis of Matters

As discussed in note 1(a) to the financial statements, the financial statements present only the Water System and do not purport to, and do not, present fairly the financial position of the City of Los Angeles, California, as of June 30, 2020 and 2019, the changes in its financial position or, where applicable, its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 3-15 and the other required supplementary information on pages 78-83 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated November 30, 2020 on our consideration of the Water System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely 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 effectiveness of the Water System's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Water System's internal control over financial reporting and compliance.

KPMG LLP

Los Angeles, California
November 30, 2020

**DEPARTMENT OF WATER AND POWER
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Management's Discussion and Analysis

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The following discussion and analysis of the financial performance of the Department of Water and Power of the City of Los Angeles' Water Revenue Fund (Water System) provides an overview of the financial activities for the fiscal years ended June 30, 2020 and 2019. Descriptions and other details pertaining to the Water System are included in the notes to the financial statements. This discussion and analysis should be read in conjunction with the Water System's financial statements, which begin on page 16.

Using this Financial Report

This annual financial report consists of the Water System's financial statements and required supplementary information and reflects the self-supporting activities of the Water System that are funded primarily through the sale of water to the public it serves.

Statements of Net Position, Statements of Revenues, Expenses, and Changes in Net Position, and Statements of Cash Flows

The financial statements provide an indication of the Water System's financial health. The statements of net position include all of the Water System's assets, deferred outflows, liabilities, deferred inflows, and net position using the accrual basis of accounting, as well as an indication about which assets can be utilized for general purposes, and which assets are restricted as a result of bond covenants and other commitments as of June 30, 2020 and 2019. The statements of revenues, expenses, and changes in net position report all of the revenues and expenses during the time periods indicated. The statements of cash flows report the cash provided and used by operating activities, capital and related financing activities, and investing activities for the years ended June 30, 2020 and 2019.

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The following tables summarize the financial condition and changes in net position of the Water System as of and for the fiscal years ended June 30, 2020, 2019, and 2018:

**Table 1 – Condensed Schedule of Assets, Deferred Outflows, Liabilities,
Deferred Inflows, and Net Position**

(Amounts in millions)

	June 30		
	2020	2019	2018
Assets and Deferred Outflows			
Utility plant, net	\$ 8,926	8,437	8,033
Investments	53	52	51
Other noncurrent assets	517	650	766
Current assets	1,116	1,090	920
Deferred outflows	320	319	388
Total assets and deferred outflows	\$ <u>10,932</u>	<u>10,548</u>	<u>10,158</u>
Net Position			
Net position:			
Net investment in capital assets	\$ 2,625	2,408	2,359
Restricted	122	112	102
Unrestricted	647	665	557
Total net position	<u>3,394</u>	<u>3,185</u>	<u>3,018</u>
Liabilities and Deferred Inflows			
Long-term debt, net of current portion	6,199	6,030	5,683
Other long-term liabilities	465	487	636
Current liabilities	711	637	594
Deferred inflows	163	209	227
Total liabilities and deferred inflows	<u>7,538</u>	<u>7,363</u>	<u>7,140</u>
Total net position, liabilities, and deferred inflows	\$ <u>10,932</u>	<u>10,548</u>	<u>10,158</u>

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Table 2 – Condensed Schedule of Revenues, Expenses, and Changes in Net Position

(Amounts in millions)

	Year ended June 30		
	2020	2019	2018
Operating revenues:			
Residential	\$ 538	515	510
Multiple-dwelling units	402	396	352
Commercial and industrial	253	262	255
Other	85	82	77
Uncollectible accounts	(2)	(2)	(4)
Total operating revenues	<u>1,276</u>	<u>1,253</u>	<u>1,190</u>
Operating expenses:			
Purchased water	\$ (160)	(155)	(185)
Maintenance and other operating expenses	(600)	(612)	(501)
Depreciation and amortization	(198)	(177)	(165)
Total operating expenses	<u>(958)</u>	<u>(944)</u>	<u>(851)</u>
Operating income	<u>318</u>	<u>309</u>	<u>339</u>
Nonoperating revenues (expense):			
Investment income	39	27	5
Federal bond subsidies	17	17	17
Other nonoperating revenues, net	6	(4)	3
Debt expense, net	(218)	(208)	(197)
Total nonoperating expense, net	<u>(156)</u>	<u>(168)</u>	<u>(172)</u>
Income before capital contributions	162	141	167
Capital contributions	<u>47</u>	<u>26</u>	<u>33</u>
Increase in net position	209	167	200
Beginning balance of net position	3,185	3,018	3,136
Cumulative effect of change in accounting for OPEB	—	—	(318)
Ending balance of net position	<u>\$ 3,394</u>	<u>3,185</u>	<u>3,018</u>

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Assets

Utility Plant

The Water System utility plant assets fall into five major categories: source of water supply, pumping, purification, distribution, and general (water infrastructure). Each category of assets is important for providing water services and has a specific purpose. During fiscal years 2020 and 2019, the Water System's net utility plant increased \$489 million and \$404 million, respectively. Net utility plant consists of significant investments in water infrastructure less accumulated depreciation.

During fiscal year 2020, utility plant additions totaled \$699 million. Approximately, \$387 million of the \$665 million in additions were construction work in progress (CWIP) expenditures and \$278 million, comprises direct additions by utility plant categories. Approximately, \$204 million in CWIP projects were transferred from CWIP to plant accounts. Major CWIP additions/expenditures during the year included: \$47 million for River Supply Conduit Upper Reach Unit 7, \$41 million for mainline replacement program, \$32 million for LA Reservoir Ultraviolet Light Treatment plant, formerly, Granada Hills reservoir, \$32 million for North Hollywood West Wellhead treatment plant, \$24 million for Headworks West reservoir to replace Ivanhoe and Silver Lake reservoir, and \$15 million to replace pipes at Foothill trunk line. Approximately, \$139 million and \$51 million of additions were transferred from CWIP to distribution plant accounts and source of supply, respectively. Major projects transferred from CWIP included \$51 million for Upper Stone Canyon Reservoir, \$48 million for San Fernando Basin Groundwater System Improvement, and \$47 million for mainline replacement at various water districts.

Direct additions are mostly related to improvements in distribution infrastructure as part of the Water System's reliability program. Many of the Water System's assets were installed between 1920 and 1970, thus the reliability program evaluates water main infrastructure to determine which assets should be replaced first to reduce leaks and the frequency of water service disruptions due to water main breaks.

Approximately, \$173 million of the additions are for improvements to the distribution system. During fiscal year 2020, the Water System invested \$148 million in programs to replace mains, services, reservoirs, tanks, and meters, including continuing replacement of existing meters with lead-free meters and fittings in accordance with the Water System's goal to increase the reliability and safety of its distribution system. Additionally, \$5 million was invested in improvements to facilities and yards that support water distribution and \$4 million went into installing new fire hydrants as ordered by the fire department to provide fire protection for new construction. A combined total of about \$9 million was invested in improvements to industrial control systems in the metro area, reservoirs, regulator stations, and facilities to further improve water distribution.

Source of supply additions totaled \$24 million in fiscal year 2020 and were primarily attributable to improvements in Owens Lake efficiency measures to reduce the use of water on regulatory requirements and improvements to south aqueduct system. During fiscal year 2020, the balance of general plant assets increased by \$57 million due to purchases of approximately \$34 million of computers/hardware, processing systems, furniture, communications equipment, customer service office automation, industrial control systems, net amortization of software, and the development of new applications. Other investments in general plant include \$11 million of fleet equipment, \$8 million for building improvements for safety codes and fire regulation,

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\$3 million for improvements to maintenance yards at Mojave and Dry Canyon for storage and fencing, and \$12 million in improvements to pumping stations.

The completion of projects for distribution, source of supply, pumping, purification, and general plant resulted in the \$204 million transfer from CWIP to depreciable assets during 2020.

During fiscal year 2020, accumulated depreciation, net of retirements increased \$192 million. The Water System uses the straight-line depreciation method for all assets based on estimated service lives. The increase in accumulated depreciation was mostly due to depreciation recognized on distribution, source of supply, and general plant assets added during the year.

During fiscal year 2019, utility plant additions totaled \$630 million. Approximately, \$359 million of the \$630 million in additions were CWIP expenditures and the balance, \$271 million, comprises direct additions by utility plant categories. Approximately, \$248 million in CWIP projects were transferred from CWIP to plant accounts. Major CWIP additions/expenditures during the year included \$39 million for mainline replacement program, \$32 million for Headworks West reservoir to replace Ivanhoe and Silver Lake reservoirs, \$19 million for LA Reservoir Ultraviolet Light Treatment plant formerly Granada Hills reservoir, \$19 million to replace pipes at Foothill trunk line, \$18 million for River Supply Conduit Upper Reach Unit 7, \$18 million for North Hollywood West Wellhead treatment plant, and \$18 million to modify Upper Stone Canyon Reservoir to comply with the Surface Water Treatment Rule. Approximately, \$103 million and \$75 million of additions were transferred from CWIP to pumping and distribution plant accounts, respectively. Major projects transferred from CWIP included \$83 million for Neenach Temporary Pump Station and \$37 million for mainline replacement at various water districts.

Approximately, \$156 million of the additions were for improvements to the distribution system. During fiscal year 2019, the Water System invested \$123 million in programs to replace mains, services, reservoirs, tanks, and meters, including continuing replacement of existing meters with lead free meters and fittings in accordance with the Water System's goal to increase the reliability and safety of its distribution system. Additionally, \$5 million went into installing new fire hydrants as ordered by the fire department to provide fire protection for new construction, and \$4 million was invested in improvements to facilities and yards that support water distribution. A combined total of \$12 million was invested in improvements to industrial control systems in the metro area, reservoirs, regulator stations, and facilities to further improve water distribution.

Source of supply additions increased by \$29 million, which is primarily attributable to improvements in Owens Lake efficiency measures to reduce the use of water on regulatory requirements. During fiscal year 2019, the balance of general plant assets increased by \$66 million due to purchases of approximately \$25 million of computers, furniture, equipment, and the development of new applications. Other investments in general plant included \$5 million for improvements to maintenance yards at Mojave and Dry Canyon for buildings, water supply, sewage systems, and paving, \$4 million for replacement of computer/hardware, software, processing systems, net amortization of software, \$4 million in improvements to pumping stations, and \$15 million to purification facilities for upgrading the technology of treatment systems.

The completion of projects for distribution, source of supply, pumping, purification, and general plant resulted in the \$248 million transfer from CWIP to depreciable assets during 2019.

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During fiscal year 2019, accumulated depreciation, net of retirements increased \$152 million. The Water System uses the straight-line depreciation method for all assets based on estimated service lives. The increase in accumulated depreciation was due to depreciation recognized on new distribution, source of supply, and general plant assets added during the year.

Source of water supply assets are the assets that the Department has installed to help ensure an adequate supply of water. The Department has four major sources of water. These include the following:

- Los Angeles Aqueduct and Second Los Angeles Aqueduct supply imported water from the Owens Valley and the Mono Basin
- Local groundwater supply (with pumping rights in the San Fernando, Sylmar, and Central and West Coast Basins)
- Purchased supply from Metropolitan Water District
- Recycled water

All sources of water, except for recycled water, are supplied for potable use, that is, the water from these sources is of drinkable quality. Table 3 below shows the percentage of water delivered from the major sources:

**Table 3 – Sources of Potable Water
Supplied during fiscal years 2020, 2019, and 2018**

	Fiscal year 2020		Fiscal year 2019		Fiscal year 2018	
	Millions of gallons	Percentage	Millions of gallons	Percentage	Millions of gallons	Percentage
Source:						
Aqueduct	89,613	58%	95,756	61%	93,880	57%
Wells	11,088	7	10,680	7	7,040	5
Purchases	50,083	33	47,726	30	59,792	36
Recycled water	3,136	2	2,447	2	3,249	2
	<u>153,920</u>	<u>100%</u>	<u>156,609</u>	<u>100%</u>	<u>163,961</u>	<u>100%</u>

The Aqueduct provided 58% of the total water supply in fiscal year 2020 compared to 61% in fiscal year 2019.

Water storage during low-demand, cold, or wet periods is essential to provide the capacity needed to supply the extra water needed during warm weather or emergency situations. The Water System's 124 tanks and reservoirs, ranging in size from 10,000 to 60 billion gallons, have a current capacity of approximately 323,820 acre feet, or 105.5 billion gallons. Nine aqueduct reservoirs provide 96% of the Water System's storage capacity; major and minor distribution reservoirs and tanks provide the remaining 4%.

Further information regarding the Water System's utility plant can be found in note 3 to the financial statements.

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Other Noncurrent Assets

During fiscal year 2020, other noncurrent assets had a net decrease of \$133 million primarily due to the use of construction funds of \$77 million, decreases in regulatory assets associated with pension and postemployment benefits (OPEB). Decreases in regulatory assets related to pension and OPEB were due to actual expense being less than actuarially determined contributions and thus the excess was used to amortize these assets as planned.

During fiscal year 2019, other noncurrent assets had a net decrease of \$116 million primarily due to decreases in regulatory assets associated with pension, OPEB, and customer care and billing system. Decreases in regulatory assets related to pension and OPEB were due to actual expense being less than actuarially determined contributions and thus the excess was used to amortize these assets as planned. Decreases in regulatory assets for the customer care and billing system of \$30 million were due to a decision made by management to expense the remaining costs related to remediation of the system.

Current Assets

During fiscal year 2020, current assets increased \$26 million mostly due to a \$46 million increase in unrestricted cash as a result of increased rates, \$30 million increase in accounts receivable due to COVID-19 since March 2020, and a \$50 million decrease in other current assets. The \$50 million in decrease on other current assets includes a \$54 million decrease in underrecovered costs due to a higher revenue compared to expenses, a \$7 million increase in accrued unbilled revenue due to an increase in unbilled consumption when comparing June 2020 to June 2019, a decrease of \$3 million in securities lending transactions, a \$1 million increase in restricted cash due to higher debt payment scheduled for July 2020, and a \$1 million decrease in prepayments and supplies.

During fiscal year 2019, current assets increased \$170 million mostly due to a \$229 million increase in unrestricted cash as a result of increased rates offset by a \$27 million decrease in accounts receivable and a \$32 million decrease in other current assets. The \$32 million decrease on other current assets includes a \$37 million decrease in underrecovered costs due to higher year-over-year consumption, a \$15 million decrease in accrued unbilled revenue due to a decrease in unbilled consumption when comparing June 2019 to June 2018, a \$16 million increase in restricted cash due to higher debt payment scheduled for July 2019, and a \$4 million increase in prepayments and supplies.

Net Position, Liabilities, and Deferred Inflows

Long-Term Debt

As of June 30, 2020, the Water System's total outstanding long-term debt balance, including the current portion was approximately \$6.33 billion. The increase of \$195 million over the previous year's balance was due to \$230 million in new debt issuance at par in fiscal year 2020, \$114 million in loans from the State of California's State Water Resources Control Board (SWRCB), offset by scheduled maturities of \$88 million, defeasance of \$30 million, and \$31 million in amortization on premiums and discounts. The bond issue was used to defease debt and finance capital improvements.

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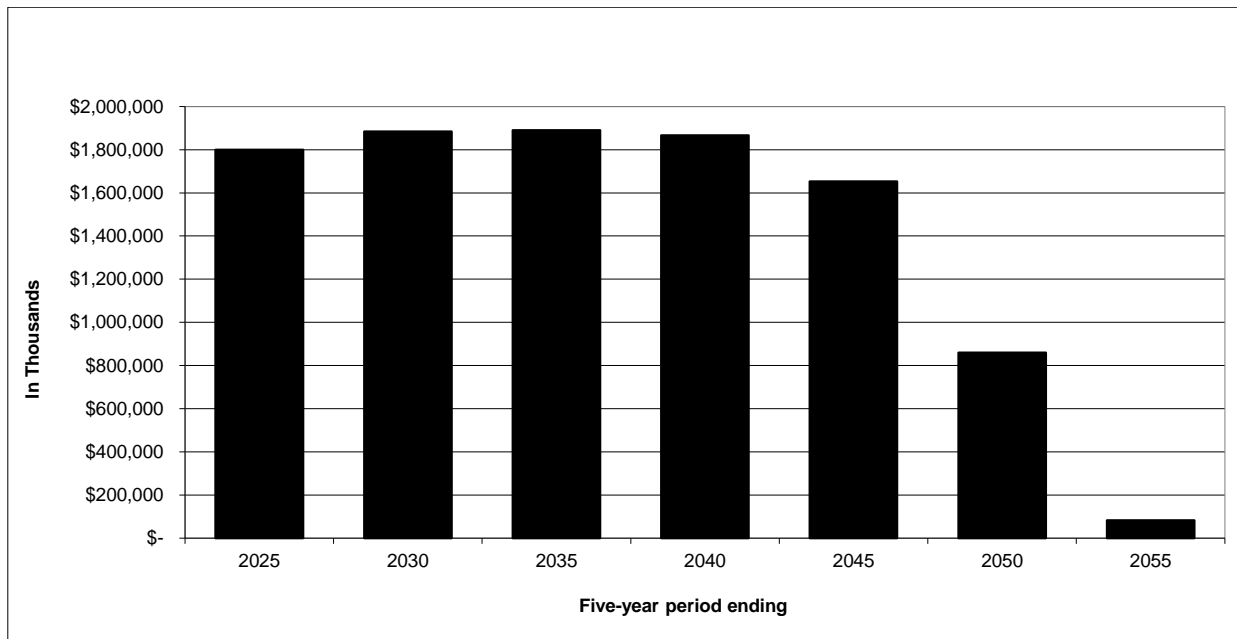
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As of June 30, 2019, the Water System's total outstanding long-term debt balance, including the current portion was approximately \$6.14 billion. The increase of \$353 million over the previous year's balance was due to \$426 million in new debt issuance at par in fiscal year 2019, \$62 million in issue premiums, \$115 million in loans from the State of California's Department of Water Resources (DWR) and the State of California's State Water Resources Control Board (SWRCB), offset by scheduled maturities of \$81 million, defeasance of \$139 million, and \$30 million in amortization on premiums and discounts. The bond issue was used to defease debt and finance capital improvements.

Scheduled payments of principal, plus scheduled interest as of June 30, 2020, are shown in the chart below:

Chart: Debt Service Requirements



In November 2020, Moody's Investors Service and Fitch Ratings affirmed the Water System's bond rating of Aa2 and AA, respectively. Also, in November 2020, Kroll Bond Rating Agency affirmed the Water System bond rating of AA+, that was assigned in August 2020. In June 2019, S&P Global Ratings affirmed the Water System's bond rating of AA+.

The Master Bond Resolution allows for parity debt to be issued as long as the Water System maintains a maximum annual adjusted debt service coverage ratio of 1.25. The debt service coverage ratio is computed by taking operating revenue less operating expense excluding depreciation expense to calculate net revenue. Net revenue is then divided by the current debt service. The Water System debt service coverage for fiscal year 2019–2020 was 1.85.

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Additional information regarding the Water System's long-term debt can be found in note 6 to the financial statements.

Other Long-Term Liabilities and Deferred Inflows

During fiscal year 2020, other long-term liabilities had a net decrease of \$22 million primarily due to a decrease in workers' compensation liability of \$9 million, a \$32 million reduction of the net pension liability, and a \$19 million increase in net OPEB and death benefits liabilities as a result of actual investment income on plan investments of 6.5% as compared to projected investment income of 7.25%.

During fiscal year 2019, other long-term liabilities had a net decrease of \$149 million primarily due to the \$134 million reduction of the net pension liability and a \$15 million decrease in net other OPEB and death benefits liabilities as a result of actual investment income on plan investments of 8.84% for pension and 9.08% for OPEB exceeding projected income of 7.25% and changes to matching contributions for pension from 7.50% to 7.25%. Actual investment income on plan investments exceeding projected income also caused deferred inflows to decrease.

During the fiscal year 2020, the Water System's net pension liability decreased \$32 million. The change in net pension liability is primarily due to employer contributions and fluctuations in the assumptions used to determine the pension liability amount.

Assuming actuarial projections are in line with actual results, the pension liability increases with pension expense and decreases with employer contributions. Differences between expected and actual experience with economic and demographic factors; the effects of changes in assumptions about future economic and demographic factors; differences between actual and projected earnings and plan investments; differences between proportionate share of collective contributions and employer's actual contributions; and the effects of changes in proportion of the collective pension amounts are recorded as deferred outflows and deferred inflows and are amortized over periods ranging from five to six years in fiscal years 2020 and 2019.

During the fiscal year 2020, the Water System's net OPEB liability increased \$19 million. The change in net OPEB liability is primarily due to employer contributions and fluctuations in the assumptions used to determine the OPEB liability amount.

Current Liabilities

During fiscal year 2020, current liabilities increased \$74 million primarily due to a \$15 million increase in customer deposits, an \$8 million increase in customer advances, a \$38 million increase in accounts payable and accrued expenses, a \$20 million increase in current portion of variable rate demand bond liquidity and \$6 million increase in long-term debt current portion, a decrease of \$4 million in accrued interest, a \$3 million decrease in securities lending transactions, and an overall net decrease of \$6 million in accrued employee expenses and due from Power System.

During fiscal year 2019, current liabilities increased \$42 million primarily due to a \$30 million increase in customer deposits, a \$9 million increase in accrued interest on bonds, and a \$4 million increase in current portion of long-term debt as a result of new issues in 2019.

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Changes in Net Position

Revenue

The operating revenue of the Water System is generated from selling water to its customers. The current water rate ordinance effective April 15, 2016 has two components, a base rate and adjustable rates, which are referred to as pass-through rates. The pass-through rates are in place to recover the cost of specific expenses. These specific expenses include purchased water, water quality, reclaimed water, demand-side management (or conservation expense), water security, Owens Valley regulatory, and low-income subsidy credits. As a result of the inclusion of pass-through rates in the water rates, revenue can increase or decrease from one year to the next based on the Water System incurring greater or smaller expenses in these categories.

The Water System has five major customer categories. These categories include residential, multiple-dwelling units, commercial, industrial, and other. Table 4 below summarizes the percentage contribution of revenue from each customer category during fiscal years 2020, 2019, and 2018:

Table 4 – Revenue and Percentage of Revenue by Customer Class

(Amounts in thousands)

	<u>Fiscal year 2020</u>		<u>Fiscal year 2019</u>		<u>Fiscal year 2018</u>	
	<u>Revenue</u>	<u>Percentage</u>	<u>Revenue</u>	<u>Percentage</u>	<u>Revenue</u>	<u>Percentage</u>
Type of customer:						
Residential	\$ 537,610	42 %	\$ 515,176	41 %	\$ 509,614	43 %
Multiple-dwelling units	402,017	32	396,035	32	352,123	30
Commercial and industrial	253,165	20	262,276	21	254,734	21
Other	84,711	6	82,100	6	77,576	6
Uncollectible accounts	(2,436)	—	(2,084)	—	(3,866)	—
	<u>\$ 1,275,067</u>	<u>100 %</u>	<u>\$ 1,253,503</u>	<u>100 %</u>	<u>\$ 1,190,181</u>	<u>100 %</u>

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Residential and multiple-dwelling units customers provided between 73% to 74% of the Water System's revenue for the 2020, 2019, and 2018 fiscal years, representing the largest class of customers. As of June 30, 2020, the Water System had approximately 689,000 customers. As shown in table 5 below, 71% of total customers were in the residential customer class as of June 30, 2020, 2019, and 2018:

Table 5 – Number of Customers and Percentage of Customers by Customer Class

(Numbers in thousands)

	<u>Fiscal year 2020</u>		<u>Fiscal year 2019</u>		<u>Fiscal year 2018</u>	
	<u>Number</u>	<u>Percentage</u>	<u>Number</u>	<u>Percentage</u>	<u>Number</u>	<u>Percentage</u>
Type of customer:						
Residential	493	71 %	491	71 %	489	71 %
Multiple-dwelling units	121	18	121	18	121	18
Commercial	61	9	60	9	59	9
Industrial	6	1	6	1	6	1
Other, including uncollectible accounts	8	1	8	1	8	1
	<u>689</u>	<u>100 %</u>	<u>686</u>	<u>100 %</u>	<u>683</u>	<u>100 %</u>

During fiscal year 2020, operating revenue increased by \$22 million, or 1.7% from fiscal year 2019, primarily due to increase in pass-through rates as a result of higher capital expenditures and operating and maintenance expenses for Water Quality projects.

Operating Expenses

Purchased water expense is generally the single largest expense the Water System incurs each fiscal year and represents the cost of buying water. During year 2020, the Water System increased its purchased water costs by \$5 million, or 3%, due to a 3% decrease in water supplied by the aqueduct, and runoff available from snowfall. The Water System continues to urge customers to make water conservation a way of life and has continued to maintain all water conservation policies and programs, and has continued investing in developing local water supplies through stormwater capture and recycled water to protect the city from future drought. See table 3 on page 8 for a summary of sources of water.

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Table 6 below summarizes the Water System's operating expenses for fiscal years 2020, 2019, and 2018:

Table 6 – Operating Expenses and Percentage of Expense by Type Expense

(Amounts in thousands)

	Fiscal year 2020		Fiscal year 2019		Fiscal year 2018	
	<u>Expenses</u>	<u>Percentage</u>	<u>Expenses</u>	<u>Percentage</u>	<u>Expenses</u>	<u>Percentage</u>
Type of expense:						
Purchased water	\$ 160,228	17 %	\$ 155,603	16 %	\$ 184,957	22 %
Other operating expenses	392,993	41	434,866	46	348,669	41
Maintenance	206,710	22	177,257	19	152,268	18
Depreciation and amortization	197,835	20	176,634	19	165,290	19
	<u>\$ 957,766</u>	<u>100 %</u>	<u>\$ 944,360</u>	<u>100 %</u>	<u>\$ 851,184</u>	<u>100 %</u>

Fiscal Year 2020

During fiscal year 2020, maintenance and other operating expenses were \$12 million lower as compared to the prior year. The decrease is primarily composed of a decrease in administrative and general corporate expense of \$17 million and offset by an increase of \$5 million in maintenance of source of water supply.

Fiscal Year 2019

During fiscal year 2019, maintenance and other operating expenses were \$111 million higher as compared to the prior year. The increase is primarily composed of an increase in customer accounting and collecting expenses of \$24 million and administrative and general corporate expense of \$24 million, an increase in source of water supply of \$19 million, an increase in distribution expenses of \$16 million, and an increase of \$4 million in other operating expenses.

**DEPARTMENT OF WATER AND POWER
OF THE CITY OF LOS ANGELES
WATER SYSTEM**

Management's Discussion and Analysis

June 30, 2020 and 2019

(Unaudited)

Nonoperating Revenue and Expenses

Fiscal Year 2020

Fiscal year 2020's nonoperating revenue, net was \$22 million higher than in fiscal year 2019. The \$22 million increase in nonoperating income can be primarily attributed to a \$12 million increase in investment income, increase in overall other nonoperating income of \$12 million and an increase in nonoperating expenses of \$2 million.

Debt expenses increased \$10 million year over year. The \$10 million net increase resulted from a \$4 million increase in interest expense due to the issuance of new debt and a \$6 million decrease in the allowance for funds used during construction. GASB 89 was adopted by the Department for fiscal year 2020 to discontinue capitalizing any interest on borrowed funds.

Capital contributions increased by \$21 million year over year due to funds received from State Grants for Proposition 1 – Sustainable Groundwater Management Program and Proposition 1 – Storm Water Grant Program total \$15 million and other increases for projects in connection with MTA and other City Departments including Airport and Harbor for new service installations, distribution mains, meter installations, fire hydrants, and acreage supply.

Fiscal Year 2019

Fiscal year 2019's nonoperating revenue was \$15.3 million higher than in fiscal year 2018. The \$15.3 million increase in other nonoperating income can be primarily attributed to a \$22 million increase in investment income as a result of increased market values of investments.

Debt expenses increased \$11 million year over year. The \$11 million net increase resulted from a \$12 million increase in interest expense due to the issuance of new debt, year-over-year increase in debt amortization expenses of \$3 million and a \$2 million decrease in the allowance for funds used during construction.

Capital contributions decreased by \$7 million due to lower funds received under Prop 84 as a result of improved drought conditions. The majority of the overall balance consists of \$25.8 million at fiscal year ended June 30, 2019 from customers for new service installations, distribution mains, meter installations, fire hydrants, and acreage supply.

**DEPARTMENT OF WATER AND POWER
OF THE CITY OF LOS ANGELES
WATER SYSTEM**

Statements of Net Position

June 30, 2020 and 2019

(Amounts in thousands)

Assets and Deferred Outflows	2020	2019
Noncurrent assets:		
Utility plant:		
Source of water supply	\$ 2,469,096	2,392,901
Pumping	429,645	403,987
Purification	866,698	867,481
Distribution	5,903,767	5,586,714
General	939,293	856,475
Total	10,608,499	10,107,558
Accumulated depreciation	(3,270,303)	(3,078,050)
Total	7,338,196	7,029,508
Construction work in progress	1,587,837	1,407,309
Total	8,926,033	8,436,817
Investments	53,414	51,981
Cash and cash equivalents – restricted	72,038	144,508
Regulatory assets – other	175,067	175,534
Regulatory asset – OPEB	155,908	179,090
Regulatory asset – pension	113,011	150,845
Total noncurrent assets	9,495,471	9,138,775
Current assets:		
Cash and cash equivalents – unrestricted	619,644	573,702
Cash and cash equivalents – restricted	193,727	192,800
Cash collateral received from securities lending transactions	4,830	7,564
Customer and other accounts receivable, net of \$41,522 and \$47,200 allowance for losses for 2020 and 2019, respectively	103,707	74,071
Underrecovered costs	40,058	94,426
Accrued unbilled revenue	101,390	94,101
Materials and supplies	25,438	27,613
Prepayments and other current assets	27,580	26,332
Total current assets	1,116,374	1,090,609
Total assets	10,611,845	10,229,384
Deferred outflows – debt refunding	20,136	22,183
Deferred outflows – pension	80,085	121,972
Deferred outflows – OPEB	38,762	3,774
Deferred outflows – pension contributions made after measurement date	139,985	134,172
Deferred outflows – OPEB contributions made after measurement date	41,008	36,455
Total deferred outflows	319,976	318,556
Total assets and deferred outflows	\$ 10,931,821	10,547,940

**DEPARTMENT OF WATER AND POWER
OF THE CITY OF LOS ANGELES
WATER SYSTEM**

Statements of Net Position

June 30, 2020 and 2019

(Amounts in thousands)

Net Position, Liabilities, and Deferred Inflows	2020	2019
Net position:		
Net investment in capital assets	\$ 2,624,870	2,408,413
Restricted:		
Debt service	88,002	79,673
Other purposes	33,636	32,636
Unrestricted	647,506	664,679
Total net position	3,394,014	3,185,401
Long-term debt, net of current portion	6,198,644	6,029,872
Other noncurrent liabilities:		
Accrued workers' compensation claims	24,346	33,530
Net pension liability	260,739	292,447
Net OPEB liability	179,653	160,692
Total other noncurrent liabilities	464,738	486,669
Current liabilities:		
Current portion of long-term debt	82,956	77,010
Current portion of variable rate demand bond liquidity advance not made	52,500	32,500
Accounts payable and accrued expenses	127,340	89,216
Due to power system	1,608	2,261
Accrued employee expenses	64,637	70,425
Accrued interest	118,465	122,453
Obligations under securities lending transactions	4,830	7,564
Customer deposits	258,351	235,136
Total current liabilities	710,687	636,565
Total liabilities	7,374,069	7,153,106
Deferred inflows – debt refunding	12,799	13,691
Deferred inflows – pension	94,913	137,114
Deferred inflows – OPEB	56,026	58,628
Total deferred inflows	163,738	209,433
Total net position, liabilities, and deferred inflows	\$ 10,931,821	10,547,940

See accompanying notes to financial statements.

**DEPARTMENT OF WATER AND POWER
OF THE CITY OF LOS ANGELES
WATER SYSTEM**

Statements of Revenues, Expenses, and Changes in Net Position

Years ended June 30, 2020 and 2019

(Amounts in thousands)

	2020	2019
Operating revenues:		
Residential	\$ 537,610	515,176
Multiple-dwelling units	402,017	396,035
Commercial and industrial	253,165	262,276
Other	84,711	82,100
Uncollectible accounts	(2,436)	(2,084)
	1,275,067	1,253,503
Operating expenses:		
Purchased water	160,228	155,603
Maintenance and other operating expenses	599,703	612,123
Depreciation and amortization	197,835	176,634
	957,766	944,360
Operating income	317,301	309,143
Nonoperating revenues (expenses):		
Investment income	38,949	26,830
Federal bond subsidies	17,437	17,381
Other nonoperating income	14,182	2,260
Total nonoperating revenue	70,568	46,471
Other nonoperating expenses	(7,979)	(5,782)
Nonoperating revenues, net	62,589	40,689
Debt expenses:		
Interest on debt	218,425	214,472
Allowance for funds used during construction	—	(5,979)
Total debt expense	218,425	208,493
Income before capital contributions	161,465	141,339
Capital contributions	47,148	25,810
Increase in net position	208,613	167,149
Net position:		
Beginning of period	3,185,401	3,018,252
End of period	\$ 3,394,014	3,185,401

See accompanying notes to financial statements.

**DEPARTMENT OF WATER AND POWER
OF THE CITY OF LOS ANGELES
WATER SYSTEM**

Statements of Cash Flows

Years ended June 30, 2020 and 2019

(Amounts in thousands)

	2020	2019
Cash flows from operating activities:		
Cash receipts:		
Cash receipts from customers	\$ 1,358,000	1,392,677
Cash receipts from customers for other agency services	659,543	608,903
Cash receipts from interfund services provided	510,512	682,701
Other cash receipts	15,951	—
Cash disbursements:		
Cash payments to employees	(374,422)	(340,716)
Cash payments to suppliers	(218,569)	(262,596)
Cash payments for interfund services used	(739,375)	(808,270)
Cash payments to other agencies for fees collected	(649,342)	(621,149)
Cash payments for property taxes	(18,770)	(16,157)
Other cash payments	—	(39,871)
Net cash provided by operating activities	543,528	595,522
Cash flows from capital and related financing activities:		
Additions to plant and equipment, net	(644,708)	(565,707)
Capital contributions	47,148	25,810
Principal payments and maturities on long-term debt	(62,730)	(57,230)
Proceeds from issuance of bonds	200,025	348,929
Proceeds from California Department of Water Resources loan	114,347	115,257
Payment of California Department of Water Resources loan	(25,626)	(23,356)
Debt interest payments	(252,554)	(234,072)
Federal bond subsidies	17,437	17,381
Net cash used in capital and related financing activities	(606,661)	(372,988)
Cash flows from investing activities:		
Purchases of investment securities	(81,901)	(86,281)
Sale of investment securities	80,639	85,257
Investment income	38,794	26,978
Net cash provided by investing activities	37,532	25,954
Net increase (decrease) in cash and cash equivalents	(25,601)	248,488
Cash and cash equivalents:		
Beginning of period	911,010	662,522
Ending of period	\$ 885,409	911,010

**DEPARTMENT OF WATER AND POWER
OF THE CITY OF LOS ANGELES
WATER SYSTEM**

Statements of Cash Flows

Years ended June 30, 2020 and 2019

(Amounts in thousands)

	2020	2019
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 317,301	309,143
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	197,835	176,634
Provision for losses on customer and other receivables	2,436	2,084
Changes in assets and liabilities:		
Customer and other accounts receivable	(32,088)	24,084
Accrued unbilled revenue	(7,289)	15,011
Underrecovered costs	54,368	36,968
Due to power system	(653)	(7,585)
Materials and supplies	2,175	(1,171)
Regulatory assets – other	(13,429)	7,345
Regulatory assets – OPEB	23,182	20,399
Regulatory assets – Pensions	37,834	78,606
Accounts payable and accrued expenses for operating	9,678	5,062
Prepayment and other current assets	(1,248)	(2,780)
Customer deposits	23,215	29,662
Accrued employee expenses	(5,788)	4,586
Deferred outflows	(3,467)	67,259
Net pension liability	(31,708)	(133,997)
Net OPEB liability	18,961	(15,456)
Deferred inflows – pensions & OPEB	(44,803)	(16,809)
Accrued workers' compensation claims and other	(2,984)	(3,523)
Net cash provided by operating activities	\$ 543,528	595,522
Supplemental disclosure of noncash capital and relating financing activities:		
During the year ended June 30, 2020, the Water System issued revenue bonds to refund previously issued debt. The \$29.7 million of proceeds were deposited immediately to a paying agent for the redemption of \$29.7 million of debt. The net gain on refunding, after the write-off of previously recorded unamortized premiums, in the amount of \$0.4 million, will be amortized over the debt repayment period and recorded as a deferred outflow.		
During the year ended June 30, 2019, the Water System issued revenue bonds to refund previously issued debt. The \$139 million of proceeds were deposited immediately into an irrevocable trust for the defeasance of \$138.7 million of debt. The net gain on refunding, after the write-off of previously recorded unamortized premiums, resulted in \$0.45 million, will be amortized over the debt repayment period and recorded as a deferred inflow.		
Accounts payable related to capital expenditures	\$ 57,175	28,729

See accompanying notes to financial statements.

**DEPARTMENT OF WATER AND POWER
OF THE CITY OF LOS ANGELES
WATER SYSTEM**

Notes to Financial Statements

June 30, 2020 and 2019

(1) Summary of Significant Accounting Policies

The City of Los Angeles Department of Water and Power (the Department) exists as a separate proprietary department of the City of Los Angeles (the City) under and by virtue of the City Charter enacted in 1925 and as revised effective July 2000. The Department's Water Revenue Fund (Water System) is responsible for the procurement, quality, and distribution of water for sale in the City. The Water System is operated as an enterprise fund of the City.

(a) Method of Accounting

The accounting records of the Water System are maintained in accordance with U.S. generally accepted accounting principles (GAAP) for governmental entities. The financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting. The Water System is accounted for as an enterprise fund and applies all applicable Governmental Accounting Standards Board (GASB) pronouncements in its accounting and reporting.

The financial statements of the Water System are intended to present the net position, and the changes in net position and cash flows of only that portion of the business-type activities and each major fund of the City that is attributable to the transactions of the Water System. They do not purport to, and do not, present fairly the financial position of the City as of June 30, 2020 and 2019, the changes in its financial position or, where applicable, its cash flows for the years then ended, in conformity with GAAP.

The Water System's rates are determined by the Board of Water and Power Commissioners (the Board) and are subject to review and approval by the Los Angeles City Council. As a regulated enterprise, the Department follows the regulatory accounting criteria set forth in the GASB Codification (GASB 62), which requires that the effects of the rate-making process be recorded in the financial statements. Such effects primarily concern the time at which revenue and expenses are recorded in net position. Accordingly, the Water System records various regulatory assets and liabilities to reflect the Board's actions by deferring expenses and revenue that are recoverable or payable from rates provided in the water rate ordinance. Regulatory liabilities are comprised of overrecovered costs and deferred inflows and regulatory assets are comprised of underrecovered costs, regulatory assets, and deferred outflows in the statement of net position. Management believes that the Water System meets the criteria for continued application and will continue to evaluate its applicability based on changes in the regulatory environment. See note 4.

(b) Use of Estimates

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

**DEPARTMENT OF WATER AND POWER
OF THE CITY OF LOS ANGELES
WATER SYSTEM**

Notes to Financial Statements

June 30, 2020 and 2019

(c) Utility Plant

The costs of additions to utility plant and replacements of retired units of property are capitalized. Costs include labor, materials, an allowance for funds used during construction (AFUDC), and allocated indirect charges, such as engineering, supervision, transportation and construction equipment, retirement plan contributions, healthcare costs, and certain administrative and general expenses. The costs of maintenance, repairs, and minor replacements are charged to the appropriate operations and maintenance expense accounts. Effective July 1, 2019 the Water System adopted GASB Statement No. 89 - *Accounting for Interest Cost Incurred before the End of a Construction Period*. See note 2 (d).

(d) Intangibles

The Water System follows GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, which requires that an intangible asset be recognized in the statement of net position only if it is considered identifiable. Additionally, it establishes a specified-conditions approach to recognize intangible assets that are internally generated. Effectively, outlays associated with the development of such assets are not capitalized until certain criteria are met. Outlays incurred prior to meeting these criteria are expensed as incurred. Intangible assets include land easements, water rights, and computer software and are capitalized and included in general utility plant on the statement of net position.

(e) Impairment of Long-Lived Assets

The Water System follows GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries* (GASB 42). Governments are required to evaluate prominent events or changes in circumstances affecting capital assets to determine whether impairment of a capital asset has occurred. A capital asset is considered impaired when its service utility has declined significantly and unexpectedly. Under GASB 42, impaired capital assets that will no longer be used by the government should be reported at the lower of carrying value or fair value. Impairment losses on capital assets that will continue to be used by the government should be measured using the method that best reflects the cause of the diminished service utility of the capital asset.

(f) Depreciation and Amortization

Depreciation expense is computed using the straight-line method based on service lives. The Water System uses the composite method of depreciation, and therefore, groups assets into composite groups for purposes of calculating depreciation expense. Estimated service lives range from 5 to 70 years. Amortization expense for computer software is computed using the straight-line method over 5 to 15 years. Depreciation and amortization expense as a percentage of average depreciable utility plant in service was 1.9% and 1.8% for fiscal years ended June 30, 2020 and 2019, respectively.

**DEPARTMENT OF WATER AND POWER
OF THE CITY OF LOS ANGELES
WATER SYSTEM**

Notes to Financial Statements

June 30, 2020 and 2019

(g) Cash and Cash Equivalents

As provided for by the State of California Government Code (the Code), the Water System's cash is deposited with the City Treasurer in the City's general investment pool for the purpose of maximizing interest earnings through pooled investment activities. The Water System considers the cash on deposit with the City Treasurer to be demand deposits as the amounts are available on demand without prior notice or penalty. Cash and cash equivalents in the City's general investment pool are reported at fair value on a recurring basis, and changes in unrealized gains and losses are recorded in the statements of revenues, expenses, and changes in net position. Interest earned on such pooled investments is allocated to the participating funds based on each fund's average daily cash balance during the allocation period. The City Treasurer invests available funds of the City and its independent operating departments on a combined basis. The Water System classifies all cash and cash equivalents that are restricted either by creditors, the Board, or by law as restricted cash and cash equivalents on the statement of net position. The Water System considers its portion of pooled investments in the City's pool to be cash and cash equivalents and the unspent construction funds as long-term restricted cash and cash equivalents.

At June 30, 2020 and 2019, restricted cash and cash equivalents include the following (amounts in thousands):

	June 30	
	2020	2019
Bond redemption and interest funds	\$ 186,841	185,914
Other restricted funds	6,886	6,886
Cash and cash equivalents – current portion	193,727	192,800
Self-insurance fund	26,750	25,750
Bond redemption funds	19,686	16,272
Construction funds	25,602	102,486
Cash and cash equivalents – noncurrent	72,038	144,508
Total restricted cash and cash equivalents	\$ 265,765	337,308

(h) Customer and Other Accounts Receivable and Allowance for Doubtful Accounts

The Water System's accounts receivables are reported net of allowance for losses. Customer account receivables result from the sale of water to city residents. Other receivables consist of billings to customers, federal, state, and local governments for work performed to improve or enhance water distribution, water sales to other utilities, and other miscellaneous receivables.

**DEPARTMENT OF WATER AND POWER
OF THE CITY OF LOS ANGELES
WATER SYSTEM**

Notes to Financial Statements

June 30, 2020 and 2019

The Water System's residential customers are billed bimonthly, and customers on monthly billings include commercial, governmental, and industrial. The Water System records an estimate for uncollectible accounts for its receivables based on an analysis of the balances in the Water System's accounts receivable aging reports. These estimates are reviewed and adjusted annually. The Water System records bad debt for its estimated uncollectible accounts related to water customer and noncustomer billings as a reduction in the Water operating revenue.

At June 30, 2020 and 2019, customer and other accounts receivable include the following (amounts in thousands):

	June 30	
	2020	2019
Customer and other accounts receivable	\$ 145,229	121,271
Allowance for losses	(41,522)	(47,200)
Customer and other accounts receivable, net	\$ 103,707	74,071

(i) Materials and Supplies

Materials and supplies are recorded at average cost.

(j) Accrued Unbilled Revenue

Accrued unbilled revenue is the receivable for estimated water sales during the period at the appropriate rates for which service has been provided but the customer has not been billed.

(k) Investments

The Water System follows GASB Statement No. 72, *Fair Value Measurement and Application*, which addresses accounting and fair value reporting issues related to fair value measurements by clarifying the definition of fair value, establishing general principles for measuring fair value, providing additional fair value application guidance, and enhancing disclosures about fair value measurements. This statement established a three-level hierarchy of inputs to valuation techniques used to measure fair value. The Water System's investments consist of investments held in the Water Expense Stabilization Fund to stabilize water rates. Such investments include U.S. government and governmental agency securities. Investments are reported at fair value on a recurring basis, and changes in unrealized gains and losses are recorded in the statements of revenue, expenses, and changes in net position. The stated fair value of investments is generally based on published market prices or quotations from major investment dealers. See note 5.

**DEPARTMENT OF WATER AND POWER
OF THE CITY OF LOS ANGELES
WATER SYSTEM**

Notes to Financial Statements

June 30, 2020 and 2019

(l) Accrued Employee Expenses

Accrued employee expenses include accrued payroll and an estimated liability for vacation leave, sick leave, and compensatory time, which are accrued when employees earn the rights to the benefits. Below is a schedule of accrued employee expenses as of June 30, 2020 and 2019 (amounts in thousands):

	June 30	
	2020	2019
Type of expense:		
Accrued payroll	\$ 13,739	16,538
Accrued vacation	32,235	36,707
Accrued sick time	7,631	7,249
Compensatory time	11,032	9,931
Total	\$ 64,637	70,425

(m) Debt Expenses

Debt premiums and discounts are capitalized and amortized to debt expense using the effective-interest method over the lives of the related debt issues. Gains and losses on refunding related to bonds redeemed by proceeds from the issuance of new bonds are reported as deferred inflows or outflows of resources and amortized to interest expense using the effective-interest method over the shorter of the life of the new bonds or the remaining term of the bonds refunded. Debt issuance costs are expensed in the year incurred.

(n) Accrued Workers' Compensation Claims

Liabilities for unpaid workers' compensation claims are recorded at their net present value. See note 9.

(o) Customer Deposits

Customer deposits represent deposits collected from customers upon opening new accounts. These deposits are obtained when the customer does not have a previously established credit history with the Department. Original deposits plus interest are paid to the customer once a satisfactory payment history is maintained, generally after one to three years.

The Water System is responsible for collection, maintenance, and refunding of these deposits for all Department customers, including those of the Department's Power Revenue Fund (Power System). As such, the Water System's statements of net position include a deposit liability of \$258 million and \$235 million as of June 30, 2020 and 2019, respectively, for all customer deposits collected.

(p) Revenue

The Water System's rates are established by a rate ordinance set by the Board based on its powers and duties established in Section 676 of the City Charter. The Water System sells water to other City

**DEPARTMENT OF WATER AND POWER
OF THE CITY OF LOS ANGELES
WATER SYSTEM**

Notes to Financial Statements

June 30, 2020 and 2019

Departments at rates provided in the ordinance. The Water System recognizes water costs in the period incurred and accrues for estimated water sold but not yet billed.

Revenue consists of billings to customers for water consumption at rates specified in the water rate ordinance. These rates include cost adjustment factors that provide the Water System with full recovery of water supply costs; water quality improvement expenditures and water security costs; base rate revenue based upon established revenue targets published for each major customer class; Owens Valley regulatory costs; lifeline and low-income customer adjustments; water infrastructure costs; and funds maintained to cover costs in the event of unforeseen events impacting water service delivery. Management estimates these costs biannually for a 12-month prospective period to establish the cost recovery component of customer billings, and any difference between billed and actual costs is adjusted in subsequent billings. This difference is reflected as \$40 million and \$94 million of underrecovered costs in the accompanying statements of net position as of June 30, 2020 and 2019, respectively.

(g) Current Rate Ordinance

The current water rate ordinance has been in effect since April 15, 2016, and covers a five-year period. The water rates are set for each customer class based upon a completed formal marginal cost of service study, which is common industry practice.

For single-family residential customers, water budgets are utilized to design an expanded four-tier rate structure. The rate structure provides water conservation signals with tier thresholds set based on indoor and outdoor water budgets, which encourage conservation. Tier 1 provides 800 cubic feet for basic indoor water needs. Tier 2 provides water levels for efficient outdoor native landscaping, Tier 3 provide water levels, which represent much less efficient outdoor irrigation and nondrought-tolerant landscaping, and Tier 4 represents excessive water usage. Tiers 2 and 3 allotments also vary based on temperature zone and lot size.

Single-family residential rates are developed to recover the revenue requirement associated with providing service to this class while recognizing the increasing cost of providing water at higher levels of usage. The major differentiating amounts between tier rates are water supply costs, peak pumping, and storage costs. The Tier 1 rate represents indoor basic needs met by the least expensive sources of water supply; the Tier 2 rate covers efficient outdoor water use and reflects water supplies, which include some expensive sources of water; the Tier 3 rate is for above-average outdoor use, which may require more expensive sources of water supply; and the Tier 4 rate is for excessive use and may include the most costly sources of water supply.

The two-tier structure of the multifamily customer class has been maintained from prior rate ordinances. Multifamily tier thresholds are set based on prior winter usage characteristics for each customer. Water allotments still provide incentives for additional conservation with Tier 1 allotment reductions applied in the second (93%), third (88%), fourth (88%), and fifth (88%) year of the five-year rate action.

**DEPARTMENT OF WATER AND POWER
OF THE CITY OF LOS ANGELES
WATER SYSTEM**

Notes to Financial Statements

June 30, 2020 and 2019

The major differentiating amounts between the two-tier structure of multifamily rates are water supply costs, peak pumping, and storage costs. Tier 1 rates reflect water supplies, which include the less expensive sources of water, and the Tier 2 rate includes the higher costs of water supply sources.

The two-tier structure of the commercial and industrial customer class has been maintained from prior rate ordinances. High and Low Season Tier thresholds are also set based on prior winter usage characteristics for each customer. Water budgets still provide incentives for additional conservation with Low Season Tier 1 allotments set at 100% of prior winter usage and the High Season Tier 1 allotment set at 105% of prior winter usage.

Like the multifamily customer class, the major differentiating costs between the two-tier structure of the commercial and Industrial rates are water supply costs, peak pumping costs, and storage costs. The Tier 1 rate reflects water supplies, which include the less expensive sources of water and the Tier 2 rate includes the higher costs of water supply sources.

The rates still reflect equity consideration for water-intensive businesses, and other customers having high seasonal variation in their water usage. Fixed monthly service availability charges apply only to private fire service.

The Water System's rate ordinance contains a Water Supply Cost Adjustment Factor, a Water Quality Improvement Adjustment Factor, a Base Rate Revenue Target Adjustment Factor, an Owens Valley Regulatory Adjustment Factor, a Low-Income Subsidy Adjustment Factor, a Water Infrastructure Adjustment Factor, and a Water Expense Stabilization Factor. These factors are recovered by direct adjustments to customers' bills. The Water Supply Cost Adjustment Factor recovers the cost of Los Angeles Aqueduct water, purchased water, including water purchased from the Metropolitan Water District, groundwater, water conservation, recycled water, and any additional water supply source expenses. The Water Quality Improvement Factor recovers expenditures to equalize water quality throughout the city, to meet state and federal water quality standards, and to provide security for water supply, storage, and conveyance infrastructure and related facilities. The Base Rate Revenue Target Adjustment recovers any shortage in revenue from base rates or credits back any excess collection of revenue from base rates due to variation in water sales from established revenue targets published for each major customer class. The Owens Valley Regulatory Adjustment factor recovers expenditures for the Owens Lake Dust Mitigation Program, the Lower Owens River Project, and the Owens Lake Master Project. The Low-Income Subsidy Adjustment Factor recovers the cost of credits provided to lifeline and low-income customers. The Water Infrastructure Adjustment Factor recovers capital costs associated specifically with infrastructure investments to maintain and improve the reliability of the water distribution system, and the Water Expense Stabilization Factor recovers funds in order to stabilize rates in the event of unforeseen events impacting water service delivery and also the expense for legal and courts costs or any judgment or settlement.

Operating revenue is revenue generally derived from activities that are billable in accordance with the water rate ordinance established by the City of Los Angeles. Other types of revenue are generally considered nonoperating.

**DEPARTMENT OF WATER AND POWER
OF THE CITY OF LOS ANGELES
WATER SYSTEM**

Notes to Financial Statements

June 30, 2020 and 2019

(r) Capital Contributions

Capital contributions and other grants received by the Water System are for constructing utility plant and other activities and are recognized when all applicable eligibility requirements, including time requirements, are met.

(s) Allowance for Funds Used during Construction (AFUDC)

An AFUDC charge represents the cost of borrowed funds used for the construction of utility plant. Capitalized AFUDC is included as part of the cost of utility plant and as a reduction of interest expenses. As of June 30, 2019, the average AFUDC rates used by the Water System was 3.8%. The Department adopted GASB 89 in fiscal year 2020 and any interest on borrowed funds will be expensed as incurred.

(t) Use of Restricted and Unrestricted Resources

The Water System's policy is to use unrestricted resources prior to restricted resources to meet expenses to the extent that it is prudent from an operational perspective. Once it is not prudent, restricted resources will be utilized to meet intended obligations.

(u) Pensions

Eligible employees of the Water System are members of the Water and Power Employees' Retirement Plan (the Plan), which is a single employer defined-benefit pension plan. The Water System's policy is to fund all the required actuarially determined contributions; such costs to be funded are determined annually as of July 1 by an actuary utilized by the Plan. The assets of the Plan are accumulated and reported at fair value in a special trust fund of the City and, therefore, are not reported in the accompanying financial statements.

The Water System recognizes a net pension liability, which represents the Water System's proportionate share of the excess of the total pension liability over the fiduciary net position of the pension plan as reflected in the financial statements of the Plan. The net pension liability is measured as of the Water System's prior fiscal year-end. Changes in the net pension liability are recorded, in the period incurred, as pension expense or as deferred inflows of resources or deferred outflows of resources depending on the nature of the change. The changes in net pension liability that are recorded as deferred inflows of resources or deferred outflows of resources (that arise from changes in actuarial assumptions or other inputs and differences between expected or actual experience) are amortized over the weighted average remaining service life of all participants in the respective pension plan and are recorded as a component of pension expense beginning with the period in which they are incurred. Projected earnings on pension investments are recognized as a component of pension expense. Differences between projected and actual investment earnings are reported as deferred inflows of resources or deferred outflows of resources and amortized as a component of pension expense on a closed basis over a five-year period beginning with the period in which the difference occurred. Each subsequent year will incorporate an additional closed basis five-year period of recognition. Contributions made after the measurement date are recorded as deferred outflows and a reduction to the pension regulatory asset.

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For purposes of measuring the net pension liability and deferred outflows/inflows or resources relating to pensions and pension expense, information about the fiduciary net position of the Water System's pension plan and additions to/deductions from the Plan's fiduciary net position has been determined on the same basis as they are reported by the Plan. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms.

(v) Other Postemployment Plan Benefits

Eligible employees of the Water System are members of the Water and Power Employees' Retirement Plan, which comprises a single-employer defined-benefit plan and a system of benefits. In addition to pension benefits, retirees can also receive other postemployment benefits (OPEB), mainly, healthcare and death benefits. The level of benefits is determined based on their years of civil service, age, and which pension tier they belong to.

The Water System's policy is to fund all the required actuarially determined contributions; such costs to be funded are determined annually as of July 1 by an actuary utilized by the Plan. The assets of the Plan are accumulated and reported at fair value in a special trust fund of the City and, therefore, are not reported in the accompanying financial statements.

The Water System recognizes a net OPEB liability, which represents the Water System's proportionate share of the excess of the total OPEB liability over the fiduciary net position of the Plan as reflected in the financial statements of the Plan. The net OPEB liability is measured as of the Water System's prior fiscal year-end. Changes in the net OPEB liability are recorded, in the period incurred, as OPEB expense or as deferred inflows of resources or deferred outflows of resources depending on the nature of the change. The changes in net OPEB liability that are recorded as deferred inflows of resources or deferred outflows of resources (that arise from changes in actuarial assumptions or other inputs and differences between expected or actual experience) are amortized over the weighted average remaining service life of all participants in the respective pension plan and are recorded as a component of OPEB expense beginning with the period in which they are incurred. Projected earnings on pension investments are recognized as a component of OPEB expense. Differences between projected and actual investment earnings are reported as deferred inflows of resources or deferred outflows of resources and amortized as a component of OPEB expense on a closed basis over a five-year period beginning with the period in which the difference occurred. Each subsequent year will incorporate an additional closed basis five-year period of recognition. Contributions made after the measurement date are recorded as deferred outflows and a reduction to the OPEB regulatory asset.

For purposes of measuring the net OPEB liability and deferred outflows/inflows or resources relating to OPEB and OPEB expense, information about the fiduciary net position of the Water System's Plan and additions to/deductions from the plan's fiduciary net position has been determined on the same basis as they are reported by the Plan. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit's terms.

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(2) Recent Accounting Pronouncements

(a) GASB Statement No. 84

In January 2017, the GASB issued Statement No. 84, *Fiduciary Activities*, effective for financial statements with fiscal years beginning after December 15, 2019. The objective of this Statement is to improve guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how these activities should be reported. The Water System adopted the provisions of Statement No. 84 in fiscal year 2020; however, the impact was not material to the Water System's financial statements.

(b) GASB Statement No. 87

In June 2017, the GASB issued Statement No. 87, *Leases*, effective for the Water System's fiscal year beginning July 1, 2021. The purpose of this statement is to enhance consistency in accounting and financial reporting by providing a methodology for identifying and reporting lease arrangements and obligations. Management has not yet determined the impact of GASB Statement No. 87 on the Water System's financial statements, but plans to adopt new GASB 87 standards in fiscal year 2022.

(c) GASB Statement No. 88

In March 2018, the GASB issued Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placement*. The Water System adopted the provisions of Statement No. 88 in fiscal year 2019 retroactive to July 1, 2017. The purpose of this statement is to improve the information that is disclosed in the notes to government financial statements related to debt, including direct borrowings and direct placements. It also clarifies which liabilities governments should include when disclosing information related to debt. The Water System's net position was not restated as a result of adoption of this standard. See additional required disclosures at note 6.

(d) GASB Statement No. 89

In June 2018, the GASB issued Statement No. 89, *Accounting for Interest Cost Incurred before the End of a Construction Period*, effective for the Water System's fiscal year beginning July 1, 2019. The objectives of this statement are (1) to enhance the relevance and comparability of information about capital assets and the cost of borrowing and (2) to simplify accounting for interest costs incurred before the end of a construction period. The Water System adopted the provisions of Statement No. 89 in fiscal year 2020; however, the impact was not material to the Water System's financial statements.

(e) GASB Statement No. 90

In August 2018, the GASB issued Statement No. 90, *Majority Equity Interests, an amendment of GASB Statements No. 14 and No. 61*. The objective of this statement is to help clarify situations in which a government's purpose for holding a majority equity interest met both the definition of an investment and the criteria to be reported as a component unit. This standard addresses accounting and financial reporting guidance for (1) A government's majority equity interest in an organization that remains legally separate after acquisition and (2) Reporting component units in which the government acquires a 100 percent equity interest. The Water System adopted the provisions of Statement No. 90 in fiscal year 2020; however, the Water System does not own a majority equity interest in a legally

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separate organization for purposes of income or profit and is not a majority equity interest in an organization that is reported as a component unit. There is no impact to the Water System's financial statements as a result of implementing GASB No. 90.

(3) Utility Plant

The Water System had the following activity in utility plant during fiscal year 2020 (amounts in thousands):

	<u>Balance, June 30, 2019</u>	<u>Additions</u>	<u>Retirements and disposals</u>	<u>Transfers</u>	<u>Balance, June 30, 2020</u>
Nondepreciable utility plant:					
Land and land rights	\$ 165,355	34,387	—	—	199,742
Construction work in progress	1,407,309	387,455	(3,337)	(203,590)	1,587,837
Total nondepreciable utility plant	<u>1,572,664</u>	<u>421,842</u>	<u>(3,337)</u>	<u>(203,590)</u>	<u>1,787,579</u>
Depreciable utility plant:					
Source of water supply	2,277,883	24,440	—	50,775	2,353,098
Pumping	401,889	12,427	—	13,231	427,547
Purification	858,598	5,329	—	(6,114)	857,813
Distribution	5,556,842	172,907	(2,610)	138,854	5,865,993
General	846,991	62,405	(11,934)	6,844	904,306
Total depreciable utility plant	<u>9,942,203</u>	<u>277,508</u>	<u>(14,544)</u>	<u>203,590</u>	<u>10,408,757</u>
Accumulated depreciation:					
Source of water supply	(481,813)	(35,570)	—	—	(517,383)
Pumping	(145,312)	(9,003)	—	—	(154,315)
Purification	(255,724)	(18,177)	—	—	(273,901)
Distribution	(1,770,705)	(97,779)	2,610	—	(1,865,874)
General	(424,496)	(34,334)	—	—	(458,830)
Total accumulated depreciation	<u>(3,078,050)</u>	<u>(194,863)</u>	<u>2,610</u>	<u>—</u>	<u>(3,270,303)</u>
Total utility plant, net	<u>\$ 8,436,817</u>	<u>504,487</u>	<u>(15,271)</u>	<u>—</u>	<u>8,926,033</u>

Depreciation and amortization expense during fiscal year 2020 was \$197.8 million.

Land and land rights are included in the balance sheet as utility plant assets in their functional category.

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The Water System had the following activity in utility plant during fiscal year 2019 (amounts in thousands):

	<u>Balance, June 30, 2018</u>	<u>Additions</u>	<u>Retirements and disposals</u>	<u>Transfers</u>	<u>Balance, June 30, 2019</u>
Nondepreciable utility plant:					
Land and land rights	\$ 172,421	21	(9,800)	2,713	165,355
Construction work in progress	1,330,975	359,401	(32,799)	(250,268)	1,407,309
Total nondepreciable utility plant	<u>1,503,396</u>	<u>359,422</u>	<u>(42,599)</u>	<u>(247,555)</u>	<u>1,572,664</u>
Depreciable utility plant:					
Source of water supply	2,222,846	29,210	—	25,827	2,277,883
Pumping	294,972	4,286	—	102,631	401,889
Purification	826,166	15,564	—	16,868	858,598
Distribution	5,334,796	155,773	(9,031)	75,304	5,556,842
General	776,763	66,086	(22,783)	26,925	846,991
Total depreciable utility plant	<u>9,455,543</u>	<u>270,919</u>	<u>(31,814)</u>	<u>247,555</u>	<u>9,942,203</u>
Accumulated depreciation:					
Source of water supply	(438,115)	(43,698)	—	—	(481,813)
Pumping	(139,543)	(5,769)	—	—	(145,312)
Purification	(241,559)	(14,165)	—	—	(255,724)
Distribution	(1,697,294)	(82,442)	9,031	—	(1,770,705)
General	(409,380)	(28,470)	13,354	—	(424,496)
Total accumulated depreciation	<u>(2,925,891)</u>	<u>(174,544)</u>	<u>22,385</u>	<u>—</u>	<u>(3,078,050)</u>
Total utility plant, net	<u>\$ 8,033,048</u>	<u>455,797</u>	<u>(52,028)</u>	<u>—</u>	<u>8,436,817</u>

Depreciation and amortization expense during fiscal year 2019 was \$176.6 million.

Land and land rights are included in the balance sheet as utility plant assets in their functional category.

(4) Regulatory Assets

Regulatory assets are created by the actions of the Board of Water and Power Commissions by deferring certain expenses that are recoverable by future rate charges in accordance with the current rate ordinances, so as to more evenly match the recognition of revenue and expenses with the water rates charged to retail customers.

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Below is a summary of the Water System's regulatory assets (amounts in thousands):

Description	June 30, 2019	Additions	Reductions	June 30, 2020
Assets:				
(a) Regulatory assets – water conservation rebates	\$ 115,642	8,778	(11,244)	113,176
(b) Regulatory assets – stormwater capture program	45,700	4,800	(1,285)	49,215
(c) Regulatory assets – customer care and billing system	14,192	—	(1,516)	12,676
Regulatory assets – other	175,534	13,578	(14,045)	175,067
(d) Regulatory assets – Pension	150,845	—	(37,834)	113,011
(e) Regulatory assets – OPEB	179,090	—	(23,182)	155,908
(f) Underrecovered costs	94,426	40,058	(94,426)	40,058
Total	\$ 599,895	53,636	(169,487)	484,044

Description	June 30, 2018	Additions	Reductions	June 30, 2019
Assets:				
(a) Regulatory assets – water conservation rebates	\$ 116,375	10,254	(10,987)	115,642
(b) Regulatory assets – stormwater capture program	34,548	11,937	(785)	45,700
(c) Regulatory assets – customer care and billing system	44,969	—	(30,777)	14,192
Regulatory assets – other	195,892	22,191	(42,549)	175,534
(d) Regulatory assets – Pension	229,451	—	(78,606)	150,845
(e) Regulatory assets – OPEB	199,489	—	(20,399)	179,090
(f) Underrecovered costs	131,394	94,426	(131,394)	94,426
Total	\$ 756,226	116,617	(272,948)	599,895

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(a) Regulatory Assets – Water Conservation Rebates

Water conservation is an integral part of the water resources management efforts and is a key element of maintaining a sustainable supply of water for the city. The Water System provides customers with 26 water conservation programs that are designed to reduce indoor and outdoor water usage. Initially the programs included low-flow showerheads and incentives to customers who purchase the high-efficiency toilets and high-efficiency clothes washing machines in an effort to reduce water use. In 2015, the program was expanded to include outdoor water savings through a turf reduction program to encourage replacing water-guzzling grass with low-water use shrubs and permeable walkways.

As provided in the Water System's rate structure, beginning June 2011, customers' bills include a charge, related to water conservation program payments to be collected over the useful life of the program, which ranges from 5 to 20 years. As rates are established at a level sufficient to recover all such costs, the Water System recorded these costs as a regulatory asset.

(b) Regulatory Assets – Watershed Management Stormwater Capture Program

The goal of the Stormwater Capture Program is to capture stormwater for recharging the basin with water that would otherwise run off to the ocean and, thus, be lost as a usable source to customers. Regulatory assets related to the Watershed Management Programs include investing in dams, reservoirs, and spreading grounds owned by other agencies, but the water collected benefits Water System customers.

As provided in the Water System's rate structure, beginning August 2013, customers' bills include a charge, related to payments made related to the Stormwater Capture Program to be collected over a period of at least 30 years. As rates are established at a level sufficient to recover all such costs, the Water System recorded these costs as a regulatory asset.

(c) Regulatory Assets – Customer Care and Billing System

In 2013, the Water System implemented the customer care and billing system (CC&B). The implementation of the system required significant investment in training of the Water System's employees.

As provided in the Water System's rate structure, beginning January 2014, customers' bills include a charge related to training for the CC&B to be collected over a 10-year period. As rates are established at a level sufficient to recover all such costs, the Water System recorded a regulatory asset.

During fiscal year 2019, the Water System's management determined that certain costs originally capitalized as a regulatory asset were not expected to move forward for regulatory asset rate recovery. As a result, \$29,538 was removed from regulatory assets and reclassified as operating expenses or general plant assets based on the expenditure. Remaining costs in CC&B regulatory asset relate to training costs on the system and will be recovered through future rates.

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(d) Regulatory Assets – Pension

In connection with the recognition of the net pension liability under GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, an amendment of GASB Statement No. 27, the Water System established a regulatory asset in the amount of \$745,477 thousand equal to the net pension liability reported at July 1, 2013. The pension regulatory asset is expected to be amortized over a period not to exceed 15 years. Amortization of the regulatory asset is the difference between amounts paid toward actuarially determined contributions and actual pension expense and totaled \$37,834 thousand and \$78,606 thousand for the years ended June 30, 2020 and 2019, respectively.

(e) Regulatory Assets – OPEB

In connection with the recognition of the net OPEB liability under GASB Statement No. 75, the Water System established a regulatory asset in the amount of \$211,740 thousand equal to the net OPEB liability reported at July 1, 2017 less contributions after the measurement date. The OPEB regulatory asset is expected to be amortized over a period not to exceed 15 years. Amortization of the regulatory asset is the difference between amounts paid toward actuarially determined contributions and actual OPEB expense, which totaled \$23,182 thousand and \$20,399 thousand for the years ended June 30, 2020 and 2019, respectively.

(f) Regulatory Assets – Underrecovered Costs

As provided in the Water System Rate Ordinance, the Water System is required to maintain balancing accounts to record differences between specific costs incurred and amounts billed through rates to recover those costs. Underrecovered costs are shown as a current asset on the statements of net position and represent the net balance in the balancing accounts when the total amounts billed through rates are less than the total costs the Water System has incurred. All of the balancing accounts are expected to be settled within a 12-month period through the billing process. At fiscal year-end June 30, 2020, the under recovered balance of \$40,058 thousand is composed of total under recovered balancing accounts of \$107,155 thousand less total over recovered balancing accounts of \$67,097 thousand. At fiscal year-end June 30, 2019, the under recovered balance of \$94,426 thousand is composed of total under recovered balancing accounts of \$160,741 thousand less total over recovered balancing accounts of \$66,315 thousand.

(5) Cash, Cash Equivalents, and Investments

(a) Investments

A summary of the Water System's investments is as follows (amounts in thousands):

Description	June 30	
	2020	2019
Water Expense Stabilization Fund	\$ 53,414	51,981

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All investments are to be used for a designated purpose as follows:

(i) *Water Expense Stabilization Fund*

The Water Expense Stabilization Fund was established under the Master Bond Resolution and can be withdrawn upon and applied to any lawful purpose in connection with the Water System.

As of June 30, 2020, the Water System's investments and their maturities are as follows (amounts in thousands):

Type of investments	Fair value	Investment maturities			
		1 to 30 days	31 to 60 days	61 to 365 days	366 days to 5 years
U.S. government securities \$	13,759	—	165	11,534	2,060
U.S. government agencies	10,585	999	—	3,554	6,032
Supranationals	1,006	—	—	1,006	—
Medium-term corporate notes	11,122	—	1,002	4,927	5,193
Commercial paper	2,995	999	998	998	—
Negotiable CDs	3,528	2,022	501	1,005	—
California local agency bonds	6,876	1,000	1,881	150	3,845
Other state bonds	3,542	1,000	1,006	505	1,031
Money market fund	1	1	—	—	—
	<u>\$ 53,414</u>	<u>6,021</u>	<u>5,553</u>	<u>23,679</u>	<u>18,161</u>

As of June 30, 2019, the Water System's investments and their maturities are as follows (amounts in thousands):

Type of investments	Fair value	Investment maturities			
		1 to 30 days	31 to 60 days	61 to 365 days	366 days to 5 years
U.S. government securities \$	996	—	—	996	—
U.S. government agencies	16,863	999	1,997	10,872	2,995
Supranationals	3,993	1,000	998	996	999
Medium-term corporate notes	12,411	999	999	3,497	6,916
Commercial paper	2,992	1,999	—	993	—
Negotiable CDs	6,885	2,000	2,000	2,885	—
California local agency bonds	2,201	1,000	1,000	201	—
Other state bonds	5,639	—	—	4,605	1,034
Money market fund	1	1	—	—	—
	<u>\$ 51,981</u>	<u>7,998</u>	<u>6,994</u>	<u>25,045</u>	<u>11,944</u>

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(ii) *Interest Rate Risk*

The Water System's investment policy limits the maturity of its investments to a maximum of 30 years for U.S. government agency securities; 5 years for supranational securities; medium-term corporate notes, municipal bonds, and state bonds; 270 days for commercial paper; and 397 days for negotiable certificates of deposit.

(iii) *Credit Risk*

Under its investment policy and the Code, the Water System is subject to the prudent investor standard of care in managing all aspects of its portfolios. The prudent investor standard requires that the Department "shall act with care, skill, prudence, and diligence under the circumstances then prevailing, including, but not limited to, the general economic conditions and the anticipated needs of the agency, that a prudent person acting in a like capacity and familiarity with those matters would use in the conduct of funds of a like character and with like aims, to safeguard the principal and maintain the liquidity needs of the agency."

The U.S. government agency securities in the portfolio consist of securities issued by government-sponsored enterprises, which are not explicitly guaranteed by the U.S. government. As of June 30, 2020 and 2019, the U.S. government agency securities in the portfolio were rated with either the highest or second highest possible credit ratings by each of the Nationally Recognized Statistical Rating Organizations (NRSROs) that rated them.

The Water System's investment policy specifies that supranational notes must be rated "AA" or its equivalent or better by an NRSRO upon purchase. As of June 30, 2020 and 2019, the Water System's investment in supranational notes was rated with the highest possible credit ratings by each of the NRSROs.

The Water System's investment policy specifies that medium-term corporate notes must be rated in a rating category of "A" or its equivalent or better by an NRSRO upon purchase. Of the Water System's investments in corporate notes as of June 30, 2020, \$3,605,028 (32%) was rated in the category of AA, and \$7,517,136 (68%) was rated in the category of A by at least one NRSRO. Of the Water System's investments in corporate notes as of June 30, 2019, \$999,065 (8%) was rated in the category of AAA, \$5,525,233 (45%) was rated in the category of AA, and \$5,886,429 (47%) was rated in the category of A by at least one NRSRO.

The Water System's investment policy specifies that commercial paper must be of the highest ranking or of the highest letter and number rating as provided for by at least two NRSROs. As of June 30, 2020 and 2019, all of the Water System's investments in commercial paper were rated with at least the highest letter and number rating as provided by at least two NRSROs.

The Water System's investment policy specifies that municipal obligations, issued by California local agencies must be rated in a rating category of "A" or its equivalent or better by an NRSRO. Of the Water System's investments in municipal bonds as of June 30, 2020, \$978,134 (14%) was rated in the category of AAA, and \$5,897,198 (86%) was rated in the category of AA by at least one NRSRO. Of the Water System's investments in municipal bonds as of June 30, 2019, \$2,201,036

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(100%) was rated in the category of A or the equivalent short-term rating or better by at least one NRSRO.

The Water System's investment policy specifies that negotiable certificates of deposit must be of the highest ranking or letter and number rating as provided for by at least two NRSROs. As of June 30, 2020 and 2019, all of the Water System's investments in negotiable certificates of deposit were rated with at least the highest letter and number rating as provided by at least two NRSROs.

The Water System's Investment Policy specifies that obligations of other states in addition to California must be rated in a rating category of "A" or its equivalent or better by an NRSRO. Of the Power System's investments in other state obligations as of June 30, 2020, \$1,536,030 (43%) was rated in the category of AA and \$2,005,890 (57%) was rated in the category of A or the equivalent or better short-term rating by at least one NRSRO. Of the Power System's investments in other state obligations as of June 30, 2019, \$4,631,949 (82%) was rated in the category of AA and \$1,006,890 (18%) was rated in the category of A by at least one NRSRO.

The Water System's investment policy specifies that money market funds may be purchased as allowed under the Code, which requires that the fund must have either (1) attained the highest ranking or highest letter and numerical rating provided by not less than two NRSROs or (2) retained an investment adviser registered or exempt from registration with the Securities and Exchange Commission with not less than five years' experience managing money market mutual funds with assets under management in excess of \$500 million. As of June 30, 2020 and 2019, the money market funds in the portfolio had attained the highest possible ratings by at least two NRSROs.

(iv) Concentration of Credit Risk

The Water System's investment policy specifies that there is no percentage limitation on the amount that can be invested in U.S. government agency securities, except that a maximum of 30% of the cost value of the portfolio may be invested in the securities of any single U.S. government agency issuer.

Of the Water System's total investments as of June 30, 2020, \$3,999,971 (7%) was invested in securities issued by the Federal Home Loan Mortgage Corporation; and \$3,323,263 (6%) was invested in securities issued by the Federal Home Loan Bank.

Of the Water System's total investments as of June 30, 2019, \$7,737,829 (15%) was invested in securities issued by the Federal Home Loan Mortgage Corporation; and \$6,958,579 (13%) was invested in securities issued by the Federal Home Loan Bank.

(v) Custodial Risk

All investments are held in the Water System's name, and therefore, they do not have custodial risk.

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(vi) *Fair Value Measurements*

The Water System holds investments that are measured at fair value on a recurring basis. Because investing is not a core part of the Department's mission, the Water System determines that the disclosures related to these investments only need to be disaggregated by major type. The Department chooses a tabular format for disclosing the levels within the fair value hierarchy. The Department categorizes its fair value measurements within the fair value hierarchy established by GAAP.

The hierarchy is based on the valuation inputs used to measure the fair value of the asset, as follows:

Level 1 inputs are quoted prices for identical assets or liabilities in an active market.

Level 2 inputs are quoted prices of similar assets or liabilities in active or not active markets.

Level 3 are unobservable inputs using the best information available to management.

	(in thousands) Fair value using				
	June 30, 2020	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Not classified
Investments by fair value level:					
Debt securities:					
U.S. government securities	\$ 13,759	13,759	—	—	—
U.S. government agencies	10,585	—	10,585	—	—
Supranationals	1,006	—	1,006	—	—
Medium-term corporate notes	11,122	—	11,122	—	—
California state bonds	—	—	—	—	—
California local agency	6,875	—	6,875	—	—
Other state bonds	3,542	—	3,542	—	—
Total debt securities	<u>46,889</u>	<u>13,759</u>	<u>33,130</u>	<u>—</u>	<u>—</u>
Other:					
Commercial paper	2,995	—	2,995	—	—
Certificate of deposit	3,529	—	3,529	—	—
Money market funds	1	—	—	—	1
Total other	<u>6,525</u>	<u>—</u>	<u>6,524</u>	<u>—</u>	<u>1</u>
Total investments	<u>\$ 53,414</u>	<u>13,759</u>	<u>39,654</u>	<u>—</u>	<u>1</u>

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		(in thousands)			
		Fair value using			
		Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Not classified
	June 30, 2019	—	—	—	—
Investments by fair value level:					
Debt securities:					
U.S. government securities	\$ 996	996	—	—	—
U.S. government agencies	16,863	—	16,863	—	—
Supranationals	3,993	—	3,993	—	—
Medium-term corporate notes	12,411	—	12,411	—	—
California state bonds	—	—	—	—	—
California local agency	2,201	—	2,201	—	—
Other state bonds	5,639	—	5,639	—	—
Total debt securities	<u>42,103</u>	<u>996</u>	<u>41,107</u>	<u>—</u>	<u>—</u>
Other:					
Commercial paper	2,992	—	2,992	—	—
Certificate of deposit	6,885	—	6,885	—	—
Money market funds	1	—	—	—	1
Total other	<u>9,878</u>	<u>—</u>	<u>9,877</u>	<u>—</u>	<u>1</u>
Total investments	<u>\$ 51,981</u>	<u>996</u>	<u>50,984</u>	<u>—</u>	<u>1</u>

Debt and other securities classified in Level 1 of the fair value hierarchy are valued using prices quoted in active markets for identical securities. Debt securities classified as Level 2 of the fair value hierarchy are valued using a multidimensional relationship model or matrix pricing model utilizing market data, including, but not limited to, benchmark yields, reported trades, and broker-dealer quotes. Money market funds with maturity dates of one year or less from the balance sheet are recorded at amortized cost and not required to be categorized.

(b) Pooled Cash

The Water System's cash and cash equivalents, and its collateral value of the City's securities lending program (SLP) are included within the City Treasury's general and special investment pool (the Pool). As of June 30, 2020 and 2019, the Water System's share of the City's general and special investment pool was \$890,239 thousand and \$918,574 thousand respectively, which represents approximately 7.2% and 8% of the Pool, respectively. Amounts pooled in the City Treasury's general and special investment pool are not required to be classified in the fair value hierarchy per GASB Statement No. 72, since they are part of an internal investment pool.

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Pooled cash is recorded as follows on the statements of net position and statements of cash flows (in thousands):

	As of June 30	
	2020	2019
Cash and cash equivalents – unrestricted	\$ 619,644	573,702
Cash and cash equivalents – restricted	193,727	192,800
Cash and cash equivalents – restricted noncurrent	72,038	144,508
Subtotal cash and cash equivalents	885,409	911,010
Cash – securities lending transactions	4,830	7,564
	\$ 890,239	918,574

The cash balances of substantially all funds on deposit in the City Treasury are pooled and invested by the City Treasurer for the purpose of maximizing interest earnings through pooled investment activities, but safety and liquidity still take precedence over return. Special pool participants include the City, airports, the Department of Water and Power, harbor, sanitation, and the Municipal Improvement Corporation of Los Angeles. Interest earned on pooled investments is allocated to and recorded in certain participating funds, as authorized by the Council and permitted by the City Charter and the Government code, based on each fund's average daily deposit balance. Unless allocation provisions are specifically stipulated in City ordinance, Council action, or funding source, interest earned on certain funds is allocated to and recorded in the general fund. The investments in the pool must comply with the California Government Code and the City's investment policy. Examples of investments permitted by the City's investment policy include U.S. Treasury bills, U.S. Treasury notes, U.S. agency securities, medium-term notes, commercial paper, asset-backed securities, and supranational obligations. The City measures and categorizes its investments using fair value measurement guidelines established by GAAP.

Pursuant to California Government Code Section 53607 and the Council File No. 94-2160, the City Treasury shall render to the Council a statement of investment policy (the Policy) annually. Council File No. 11-1740 was adopted on December 12, 2016 as the City's investment policy. This policy shall remain in effect until the Council and the Mayor approve a subsequent revision. The Policy governs the City's pooled investment practices. The Policy addresses soundness of financial institutions in which the City Treasurer will deposit funds and types of investment instruments permitted by California Government Code Sections 53600-53638, 16340, and 16429.1. The City Treasury further reports that the current policy allows for the purchase of investments with maturities up to 30 years.

The City issues a publicly available financial report that includes complete disclosures related to the City's pooled investments. The report may be obtained by writing to the City of Los Angeles, Office of the Controller, 200 North Main Street, City Hall East Suite 300, Los Angeles, California, 90012, or the Los Angeles City Controller's website <http://www.lacontroller.org/reports>.

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General Investment Pool Securities Lending Program.

Securities lending is permitted and limited under provisions of California Government Code Section 53601. The Council approved the Securities Lending Program (the SLP) on October 22, 1991 under Council File No. 91-1860, which complies with the California Government Code. The objectives of the SLP in priority order are safety of loaned securities and prudent investment of cash collateral to enhance revenue from the investment program. The SLP is governed by a separate policy and guidelines. The Water System invested \$4,830 thousand and \$7,564 thousand in the City's securities lending program as of June 30, 2020 and 2019, respectively.

The City's custodial bank acts as the securities lending agent. In the event a counterparty defaults by reason of an act of insolvency, the bank shall take all actions, which it deems necessary or appropriate to liquidate permitted investment and collateral in connection with such transaction, and shall make a reasonable effort for two business days (the Replacement Period) to apply the proceeds thereof to the purchase of securities identical to the loaned securities not returned. If during the Replacement Period the collateral liquidation proceeds are insufficient to replace any of the loaned securities not returned, the bank shall, subject to payment by the City of the amount of any losses on any permitted investments, pay such additional amounts, as necessary, to make such replacement.

Under the provisions of the SLP, and in accordance with the California Government Code, no more than 20% of the market value of the General Investment Pool (the Pool) is available for lending. The City loans out U.S. Treasury Notes and U.S. Agencies Securities. The City receives cash as collateral on the loaned securities, which is reinvested in securities permitted under the Policy. In addition, the City receives securities as collateral on loaned securities, which the City has no ability to pledge or sell without borrower default. In accordance with the California Government Code, the securities lending agent marks to market the value of both the collateral and the reinvestments daily. Except for open loans where either party can terminate a lending contract on demand, term loans have a maximum life of 92 days. Earnings from securities lending accrue to the Pool and are allocated on a pro rata basis to all Pool participants.

During the fiscal year 2020 and 2019, collateralizations on all loaned securities were compliant with the required 102% of the market value. The City can sell collateral securities only in the event of borrower default. The lending agent provides indemnification for borrower default. There were no violations of legal or contractual provisions and no borrower or lending agent default losses during the fiscal year. There was no credit risk exposure to the City because the amounts owed to the borrowers exceeded the amounts borrowed. Loaned securities are held by the City's agents in the City's name and are not subject to custodial credit risk.

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(6) Long-Term Debt

Long-term debt outstanding as of June 30, 2020 and 2019 consists of revenue bonds and refunding revenue bonds due serially in varying annual amounts, and other long-term debt, as follows (amounts in thousands):

Bond issues	Date of issue	Effective interest rate%	Fiscal year of last scheduled maturity	Principal outstanding		
				2020	2019	
Revenue bonds:						
Issue of 2001, Series B	02/28/01	Variable	2036	\$	325,000	325,000
Issue of 2003, Series B	03/06/03	4.014	2031		8,780	8,780
Issue of 2009, Series B	12/03/09	3.252	2021		—	57,970
Issue of 2009, Series C	12/03/09	3.844	2040		346,090	346,090
Issue of 2010, Series A	12/14/10	4.374	2051		492,710	492,710
Issue of 2011, Series A	08/24/11	4.542	2042		290,065	299,665
Issue of 2012, Series A	06/06/12	4.319	2044		276,765	276,765
Issue of 2012, Series B	08/09/12	4.023	2044		322,000	322,000
Issue of 2012, Series C	08/09/12	2.483	2027		92,715	92,715
Issue of 2013, Series A	05/30/13	2.797	2035		78,225	83,895
Issue of 2013, Series B	12/05/13	3.836	2036		343,185	354,365
Issue of 2014, Series A	11/20/14	3.987	2045		267,805	271,000
Issue of 2016, Series A	04/21/16	3.184	2047		628,615	628,615
Issue of 2016, Series B	06/09/16	3.111	2047		265,730	265,730
Issue of 2017, Series A	05/11/17	3.825	2048		527,865	529,055
Issue of 2018, Series A	03/01/18	3.576	2049		231,000	231,000
Issue of 2018, Series B	11/29/18	3.802	2049		422,665	426,330
Issue of 2019, Series A	07/01/19	Variable	2050		229,765	—
Total principal amount					5,148,980	5,011,685
Unamortized premiums and discounts					446,086	477,384
Revenue bonds, net					5,595,066	5,489,069
Debt due within one year, long-term debt					(65,985)	(62,730)
Debt due within one year, variable rate demand bond liquidity advance not made					(52,500)	(32,500)
Revenue bonds, noncurrent, net					5,476,581	5,393,839

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Bond issues	Date of issue	Effective interest rate%	Fiscal year of last scheduled maturity	Principal outstanding	
				2020	2019
Other long-term debt:					
Loans payable to California State Water Resources Control Board					
SRF1997CX101	12/27/01	2.320 %	2024	\$ 4,234	4,736
SRF02CX139	06/28/07	2.600 %	2030	14,250	15,483
SRF06CX144	09/11/07	2.452 %	2030	20,364	22,273
SRF06CX147	06/28/07	2.292 %	2030	21,528	23,423
SRF10CX103	06/24/10	—	2035	32,790	35,132
SRF10CX104	06/24/10	—	2033	5,984	6,462
SRF11CX105	06/30/11	—	2035	17,307	18,501
SRF10CX116	06/30/11	—	2034	12,500	13,500
SRF10CX117	06/30/11	—	2033	6,250	6,750
SRF12CX105	06/30/12	—	2045	106,067	110,310
SRF12CX106	06/30/12	—	2045	27,406	28,502
SRF13CX104	06/26/13	—	2047	31,518	5,633
SRF13CX105	06/26/13	—	2047	92,169	95,583
SRF14CX102	06/26/14	2.085 %	2047	7,468	7,677
SRF14CX103	06/26/14	2.085 %	2047	49,931	51,330
SRF14CX104	06/26/14	2.085 %	2047	15,796	16,238
SRF14CX105	06/26/14	2.085 %	2047	31,144	32,017
SRF14-586-550	03/10/15	—	2022	20	40
SRF14-310-550	06/19/15	1.663 %	2040	79,128	50,839
SRF D15-02014	09/29/15	1.663 %	2036	3,214	3,394
SRF D17-02079	10/02/18	1.800 %	2050	19,978	—
SRF D17-02080	10/01/18	1.800 %	2050	7,544	—
SRF D17-02081	10/01/18	1.800 %	2052	124,117	95,370
SRF D17-02082	07/31/18	1.800 %	2049	7,327	6,120
Loans payable to California Department of Water Resources Calconserve					
	09/19/18	—	2041	1,000	1,000
Total principal amount				739,034	650,313
Amount due within one year				(16,971)	(14,280)
Loans payable, noncurrent				722,063	636,033
Total long-term debt, bonds and loans, net				\$ 6,334,100	6,139,382

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Revenue bonds generally are callable 10 years after issuance. The Water System has agreed to certain covenants with respect to bonded indebtedness. Significant covenants include the requirement that Water System's net income, as defined, will be sufficient to pay certain amounts of future annual bond interest and of future annual aggregate bond interest and principal maturities. Revenue bonds and refunding bonds are collateralized by the future revenue of the Water System.

(a) Long-Term Debt Activity

The Water System had the following activity in long-term debt during fiscal years 2020 and 2019 (amounts in thousands):

	<u>Balance June 30, 2019</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance June 30, 2020</u>
Revenue bonds:				
Principal:				
Beginning balance	\$ 5,011,685	—	—	5,011,685
Issuances	—	200,000	—	200,000
Refunding bonds	—	29,765	—	29,765
Scheduled maturities	—	—	(62,730)	(62,730)
Refunded/defeased bonds	—	—	(29,740)	(29,740)
	<u>5,011,685</u>	<u>229,765</u>	<u>(92,470)</u>	<u>5,148,980</u>
Premium (discount)				
Beginning balance	477,384	—	—	477,384
Issuances	—	—	—	—
Refunding bonds	—	—	—	—
Scheduled amortization	—	—	(30,897)	(30,897)
Written off due to refunding	—	—	(401)	(401)
	<u>477,384</u>	<u>—</u>	<u>(31,298)</u>	<u>446,086</u>
Revenue bonds, net	5,489,069	229,765	(123,768)	5,595,066
Loans from SWRCB and DWR ¹	650,313	114,347	(25,626)	739,034
Total	<u>\$ 6,139,382</u>	<u>344,112</u>	<u>(149,394)</u>	<u>6,334,100</u>

¹ During fiscal year 2019-20, the Water System did not enter into any new loan agreements with the SWRCB or DWR. Existing SWRCB loans received \$114.3 million to fund water quality capital improvements and made principal payments of \$25.6 million.

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	<u>Balance June 30, 2018</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance June 30, 2019</u>
Revenue bonds:				
Principal:				
Beginning balance	\$ 4,781,285	—	—	4,781,285
Issuances	—	305,000	—	305,000
Refunding bonds	—	121,330	—	121,330
Scheduled maturities	—	—	(57,200)	(57,200)
Refunded/defeased bonds	—	—	(138,730)	(138,730)
	<u>4,781,285</u>	<u>426,330</u>	<u>(195,930)</u>	<u>5,011,685</u>
Premium (discount)				
Beginning balance	446,714	—	—	446,714
Issuances	—	43,929	—	43,929
Refunding bonds	—	17,993	—	17,993
Scheduled amortization	—	—	(30,449)	(30,449)
Written off due to refunding	—	—	(803)	(803)
	<u>446,714</u>	<u>61,922</u>	<u>(31,252)</u>	<u>477,384</u>
Revenue bonds, net	5,227,999	488,252	(227,182)	5,489,069
Loans from SWRCB and DWR ¹	<u>558,412</u>	<u>115,257</u>	<u>(23,356)</u>	<u>650,313</u>
Total	<u>\$ 5,786,411</u>	<u>603,509</u>	<u>(250,538)</u>	<u>6,139,382</u>

¹ During fiscal year 2018-19, the Water System entered into four new loan agreements with the SWRCB and one with the DWR. The Water System drew down funds on two of the new loan agreements with the SWRCB and the new loan with the DWR during fiscal year 2019. The DWR loan received \$1 million in funding. SWRCB loans received \$114.3 million to fund water quality capital improvements and made principal payments of \$23.4 million.

(b) New Issuances

Fiscal Year 2020

In July 2019, the Water System issued \$229.8 million of Water System Variable Rate Revenue Bonds, 2019 Series A. The net proceeds of \$229.6 million, net of underwriter's discount, were used to pay for budgeted capital improvements and refund all of the outstanding Water System Revenue Bonds, 2009 Series B, amounting to \$29.7 million. The transaction resulted in a net gain for accounting purposes of \$0.4 million, which was capitalized as deferred inflows on debt refunding and is being amortized over the life of the refunded bonds.

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Fiscal Year 2019

In November 2018, the Water System issued \$426 million of Water System Revenue Bonds, 2018 Series B. The net proceeds of \$487.3 million, including \$61.0 million issue premium net of underwriter's discount, were used to pay for budgeted capital improvements and refund all of the outstanding Water System Revenue Bonds, 2009 Series A, amounting to \$138.7 million. The transaction resulted in a net present value savings of \$24.6 million and a net gain for accounting purposes of \$0.45 million, which was capitalized as deferred inflows on debt refunding and is being amortized over the life of the refunded bonds.

(c) Outstanding Debt Defeased

The Water System defeased certain revenue bonds in the prior years by placing cash or the proceeds of new revenue bonds in irrevocable trusts to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the Water System's financial statements. At June 30, 2020, the following revenue bonds outstanding are considered defeased (amounts in thousands):

Bond issues	Principal outstanding
Issue of 1998 R	\$ 66,044
	\$ 66,044

(d) Variable Rate Bonds

As of June 30, 2020 and 2019, the Water System had variable rate bonds outstanding in the amounts of \$554.8 million and \$325.0 million, respectively. The variable rate bonds currently bear interest at daily and weekly rates ranging from 0.01% to 0.12% as of June 30, 2020 and 0.95% to 1.52% as of June 30, 2019. The Water System can elect to change the interest rate period of the bonds, with certain limitations. The bondholders have the right to tender the bonds to the tender agent on any business day with seven days' prior notice. The Water System has entered into standby agreements with a syndicate of commercial banks in initial amounts of \$225 million (2001B, Subseries B-1 to B-3), \$100 million (2001B, Subseries B-4), \$130 million (2019A, Subseries A-1), \$70 million (2019A, Subseries A-2), and \$29.8 million (2019A, Subseries A-3) to provide liquidity for these bonds. The extended standby agreements expire in July 2020, January 2021, and January 2022.

Under the agreements, \$225 million variable rate bonds will bear interest that is payable monthly at the greatest of (i) Prime Rate plus 1.00%; (ii) the Federal Funds Rate plus 2.00%; and (iii) 7.50%, \$129.8 million variable rate bonds will bear interest that is payable monthly at the LIBOR Index Rate plus 7.50%, \$200 million of variable rate bonds will bear interest that is payable monthly at the greatest of (i) Prime Rate plus 1.00%; (ii) the Federal Funds Rate plus 2.00%; (iii) LIBOR plus 3.00%; and (iv) 7.00%. The unpaid principal of each liquidity advance made by the liquidity provider is payable in 10 equal semiannual installments 90 days immediately following the related liquidity advance. At its

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discretion, the Water System has the ability to convert the outstanding bonds to fixed rate obligations, which cannot be tendered by the bondholders.

The variable rate bonds have been classified as long term on the statements of net position as the liquidity facilities give the Water System the ability to refinance on a long-term basis, and the Water System intends to either renew the facilities or exercise its right to tender the debt as a long-term financing. That portion, which would be due in the next fiscal year in the event that the outstanding variable rate bonds were tendered and purchased by the commercial banks under the standby agreements, has been included in the current portion of long-term debt and was \$52.5 million and \$32.5 million as of June 30, 2020 and 2019, respectively.

(e) Direct Borrowings and Line of Credit

Under GASB 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*, the Water System has the following direct placement debt and unused line of credit:

The Drinking Water State Revolving Fund (DWSRF), administered by the State of California's State Water Resources Control Board, assists public water systems in financing the cost of drinking water infrastructure projects needed to achieve or maintain compliance with Safe Drinking Water Act (SDWA) requirements. The DWSRF utilizes a prioritized project ranking system to ensure that program resources are applied to projects addressing public health risk problems; projects needed to comply with the SDWA; and projects assisting public water systems most in need on a per household-affordability basis. The Water System has applied for and received funding from the DWSRF for critical Water System capital projects required for compliance with federal drinking water regulations, specifically the Long-Term 2 Enhanced Surface Water Treatment Rule and the Stage 2 Disinfection By Products Rule. This funding has been made available to the Water System in the form of low or 0% interest loans with a repayment period of up to 30 years.

The CalConserve Water Use Efficiency Loan Program, administered by the State of California Department of Water Resources (DWR), established a loan program to local agencies for specific types of water conservation and water use efficiency projects and programs to achieve urban water use targets. The Water System has applied for and received funding from the DWR that will be used to implement an Institutional Water Use Efficiency Loan Program. This funding has been made available to the Water System as a 0% interest loan with a repayment period of 20 years.

The direct borrowings from the DWSRF and DWR contain specified terms relating to certain default provisions as defined by each respective funding agreement. Certain default provisions under the funding agreements include, but are not limited to, material breach of the funding agreement, cessation of operations or bankruptcy, failure to pay amounts due, making false representations with respect to the funding agreements, and failure to meet compliance requirements. Some agreements may be terminated at the option of the lender upon material violation and failure to become compliant. Such termination may result in the immediate repayment of disbursed funds. The Water System does not have any assets pledged as collateral for direct borrowings or subjective acceleration clauses.

On December 14, 2018, LADWP entered into an Amended and Restated Revolving Credit Agreement (Amended RCA) and the related Amended and Restated Fee and Interest Rate Agreement with Wells

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Fargo Bank, National Association with a \$300 million commitment and the option to request additional commitment, as needed, up to a total commitment of \$500 million. The Department can request loans for Water System improvements, Power System improvements, and/or such other lawful purposes of the Department. The interest charge for tax-exempt loans is based on SIFMA plus a spread of 0.50% or 75% of one-month LIBOR plus a spread of 0.45%. The interest charge for taxable loans is based on one-month LIBOR plus a spread of 0.45%. The Amended RCA expires in December 2023. As of June 30, 2020 and 2019, the Water System has no obligations outstanding under the Amended RCA.

(f) Scheduled Principal Maturities and Interest

As of June 30, 2020, annual principal maturities and interest on an accrual basis for bonds and loans are as follows (amounts in thousands):

	<u>Principal</u>	<u>Interest and amortization</u>
Fiscal year(s) ending June 30:		
2021	\$ 82,956	218,995
2022	107,983	215,187
2023	124,251	211,003
2024	142,072	206,331
2025	148,395	201,403
2026–2030	838,610	926,794
2031–2035	1,022,108	777,248
2036–2040	1,236,062	571,084
2041–2045	1,333,729	292,634
2046–2050	770,046	86,216
2051–2055	81,802	72
Total requirements	<u>\$ 5,888,014</u>	<u>3,706,967</u>

The interest and amortization is net of \$438.75 million of unamortized discount/premium and gain/loss due to issuances of new and refunding bonds.

The maturity schedule presented above reflects the scheduled debt service requirements for all of the Water System's long-term debt, including the Water 2019 A Subseries A-3. The schedule is presented assuming that the tender options on the variable rate bonds, as discussed on the previous page, will not be exercised. Should the bondholders exercise the tender options, the Water System could be required to redeem the \$525 million in variable rate bonds outstanding over the next six fiscal years as follows: \$52.5 million in fiscal year 2021, \$105 million in each of the fiscal years 2022 through 2025, and \$52.5 million in fiscal year 2026. Accordingly, the statements of net position recognize the possibility of the exercise of the tender options and reflect the \$52.5 million that could be due in fiscal year 2020, as a current portion of long-term debt payable.

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Interest and amortization presented in the above schedule include interest requirements for the variable rate debt over the regularly scheduled maturity period. Variable debt interest rate in effect at June 30, 2020 averages 0.06%. Should the tender options be exercised, the interest would be payable at the rate in effect at the time the standby agreements are activated.

(7) Retirement Plan

(a) Plan Description

The Water System has funded a contributory retirement plan covering substantially all of its employees. The Water and Power Employees' Retirement Fund (the Fund or Plan) operates as a single-employer defined-benefit plan to provide pension benefits to eligible Department employees. The Retirement Fund's assets are held in a special trust fund of the City. Plan benefits are generally based on years of service, age at retirement, and the employee's highest 12 consecutive months of salary before retirement. Active participants who joined the Plan on or after June 1, 1984 are required to contribute 6% of their annual covered payroll. Participants who joined the Plan prior to June 1, 1984 contribute an amount based upon an entry-age percentage rate. A new Tier 2 was added to the Plan and applies to members hired on or after January 1, 2014. Tier 2 plan participants are required to contribute 10% of their salary and plan benefits are based on a three-year final average salary period.

Under the provisions of the City Charter, the Retirement Board of Administration (the Retirement Board) has the responsibility and authority to administer the Plan and to invest its assets. The Retirement Board members serve as trustees and must act in the exclusive interest of the Plan's members and beneficiaries. The Retirement Board has seven members: one member of the Board of Water and Power Commissioners, the General Manager, the Chief Accounting Employee, three employee members who are elected for three-year terms by active members of the Plan, and one retiree who is appointed by the Board of Water and Power Commissioners for a three-year term.

Plan amendments must be approved by both the Retirement Board and the Board of Commissioners of the Department. The Plan issues separately available financial statements on an annual basis. Such financial statements can be obtained from the Department of Water and Power Retirement Office, 111 N. Hope, Room 357, Los Angeles, California 90012.

(b) Benefits Provided

The Plan provides retirement benefits to eligible employees. Most employees of the Water System become members of the Plan effective on the first day of biweekly payroll following employment or immediately following transfer from another City department. Members employed prior to January 1, 2014 are designated as Tier 1 and those hired on or after January 1, 2014 are designated as Tier 2 (unless a specific exemption applies to employee providing a right to Tier 1 status).

Tier 1 members are eligible to retire once they attain the age of 60 with 5 or more years of service or at age 55 with 10 or more years of service acquired in the last 12 years prior to retirement. A Tier 1 member with 30 years of service is eligible to retire regardless of age. Tier 2 members are eligible to retire once they attain the age of 60 with at least 5 years of continuous Department service or at any age with 30 years of service. For both tiers, combined years of service between the Plan and the Los Angeles City Employees Retirement System is used to determine retirement eligibility and at least

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5 years must be actual employment at the Department or the City (not purchased). For both tiers, members receiving Permanent Total Disability benefits may retire regardless of age. For Tier 1, to be eligible for a Formula Pension, the employee must have worked or been paid disability 4 of the last 5 years immediately preceding eligibility to retire, or while eligible to retire.

The Formula Pension benefit the member will receive is based upon age at retirement, monthly average salary base, and years of retirement service credit. The Tier 1 Formula Pension is equal to 2.1% times years of service credit times monthly average salary base. In addition, members retiring after attaining age 55 with 30 years of service credit, receive an increase in the benefit factor from 2.1% to 2.3%. A reduced early retirement benefit is paid for those members attaining age 55 with 10 years of service or any age (under 55) with 30 years of service. The reduction is 1.5% for each year of retirement age between 60 and 55 and 3.0% for each year of retirement before age 55.

Under Tier 2, there are various benefit factors that apply as shown below:

- 1.5% at age 60 with 5 years of continuous Department Service (or 10 years of Qualifying Service)
- 2.0% at age 60 with 30 years of Qualifying Service
- 2.0% at age 55 with 30 years of Service credit
- 2.0% at age 63 with 5 years of continuous Department Service (or 10 years of Qualifying Service)
- 2.1% at age 63 with 30 years of Qualifying Service

Reduced early retirement benefits are still available at any age (under 55) with 30 years of service and the reduction factors are the same as Tier 1. Note that these reduction factors continue to include the reduction from age 60 to 55 and from 55 to age at retirement.

For Tier 1 members, the maximum monthly retirement allowance is 100% of monthly average salary base. For Tier 2 members, the maximum monthly retirement allowance is 80% of monthly average salary base. Under Tier 1, pension benefits are calculated based on the highest average salary earned during a 12-month period. Under Tier 2, pension benefits are calculated based on the average salary earned during a 36-month period.

The member may elect the full allowance, or choose an optional retirement allowance. The full allowance provides the highest monthly benefit and up to a 50% continuance to an eligible surviving spouse or domestic partner. There are five optional retirement allowances the member may choose. Each of the optional retirement allowances requires a reduction in the full allowance in order to allow the member the ability to provide various benefits to a surviving spouse, domestic partner, or named beneficiary.

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(c) Plan Membership

As of the June 30, 2019 and 2018 measurement dates for the June 30, 2020 and 2019 net pension liability, pension plan membership, which consisted of Water and Power System members, consisted of the following:

	2020	2019
Retired members or beneficiaries currently receiving benefits	9,315	9,165
Vested terminated members entitled to, but not yet receiving, benefits	1,663	1,728
Active members	10,362	10,114
Total	21,340	21,007

(d) Contributions

The Department contributes \$1.10 for each \$1.00 contributed by participants plus an actuarially determined annual required contribution (ARC) as determined by the Plan's independent actuary. The required contributions are allocated between the Power System and the Water System based on the current year labor costs.

Employer contribution rates are adopted annually based upon recommendations received from the Plan's actuary after the completion of the annual actuarial valuation. The average employer contribution rates for fiscal years 2020, 2019, and 2018 (based on the July 1, 2019, 2018, and 2017 valuations) were 37.97%, 40.15%, and 44.62% of compensation, respectively. The average member contribution rate for fiscal years 2020, 2019, and 2018 (based on the July 1, 2019, 2018, and 2017 valuations) was 7.35% of compensation. Most Tier 1 members contribute at 6% of compensation and all Tier 2 members contribute at 10% of compensation. Employer contributions in fiscal years 2020, 2019, and 2018 amounted to \$140 million, \$134 million, and \$141 million, respectively.

(e) Net Pension Liability

At June 30, 2020 and 2019, the Water System reported a liability of \$261 million and \$292 million, respectively, for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2019 and 2018, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of the same dates. The Water System's proportion of the net pension liability was based on the Water System's projected compensation for the year following the measurement date, relative to the projected compensation for the same period for both the Water System and the Power System. At June 30, 2020, the Water System's proportion was 31.6% compared to 32.1% and 31.7% as of June 30, 2019 and 2018, respectively.

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(f) Actuarial Assumptions

The Water System's net pension liability as of June 30, 2020 and 2019 was measured as of June 30, 2019 and 2018, using actuarial valuations as of July 1, 2019 and 2018, respectively. The actuarial assumptions used in the July 1, 2019 and 2018 valuations were based on the results of an experience study for the period from July 1, 2015 through June 30, 2018. The following assumptions were applied to all periods included in the measurement for the July 1, 2019 and 2018 actuarial valuations:

<u>Actuarial assumptions</u>	<u>2019</u>	<u>2018</u>
Inflation	2.75%	3.00%
Salary increases	4.50%–10.25%	4.50%–10.00%
Investment rate of return	7.00%	7.25%
Cost-of-living adjustments	2.75% (Actual increases are contingent upon CPI increases, with a 3.00% maximum for Tier 1 and 2.00% maximum for Tier 2.)	3.00% (Actual increases are contingent upon CPI increases, with a 3.00% maximum for Tier 1 and 2.00% maximum for Tier 2.)
Mortality	Postretirement: Pub-10 General Healthy Retiree Amount-Weighted Above Median Mortality Table times 105% for males and 100% for females, projected generationally with the two-dimensional mortality improvement scale MP-2018	Healthy postretirement: RP-2014 Healthy Annuitant Mortality Table set back one year with MP-2015 projection scale

(g) Discount Rate

The discount rate used to measure the total pension liability was 7.00% and 7.25% as of June 30, 2020 and 2019. The projection of cash flows used to determine the discount rate assumed that plan member contributions will be made at the current contribution rate and that employer contributions will be made at rates equal to the actuarially determined contribution rates. For this purpose, only employee and employer contributions that are intended to fund benefits for current plan members and their beneficiaries are included. Projected employer contributions that are intended to fund the service costs for future plan members and their beneficiaries, as well as projected contributions from future plan members, are not included. Based on those assumptions, the Plan's fiduciary net position was projected to be available to make all projected future benefit payments for current members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments, which is estimated to be 104 years, to determine the total pension liability at June 30, 2020 and 2019.

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The long-term expected rate of return on pension plan investments was determined using a building-block method in which expected future real rates of return (expected returns, net of inflation) are developed for each major asset class. These returns are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage, adding expected inflation and subtracting expected investment expenses and a risk margin. The target allocation and projected arithmetic real rates of return for each major asset class, after deducting inflation but before deducting investment expenses, used in the derivation of the long-term expected investment rate of return assumption are summarized in the following table:

<u>Asset class</u>	<u>June 2020</u>		<u>June 2019</u>	
	<u>Targeted allocation</u>	<u>Long-term expected arithmetic real rate of return</u>	<u>Targeted allocation</u>	<u>Long-term expected arithmetic real rate of return</u>
Domestic equity	25 %	5.44 %	29 %	5.76 %
Developed international equity	15	6.54	19	7.25
Fixed income	25	1.65	25	1.74
Real estate	8	4.60	8	4.37
Real return	5	2.07	5	2.39
Private equity	16	9.27	8	7.75
Covered calls	5	3.53	5	3.50
Cash and equivalents	1	0.25	1	(0.46)
	<u>100 %</u>		<u>100 %</u>	

(h) Sensitivity of the Net Pension Liability to Changes in the Discount Rate

The following presents the net pension liability of the Water System as of June 30, 2020 and 2019, calculated using the discount rate of 7.00% and 7.25%, respectively, as well as what the Department's pension liability would be as of June 30, 2020 if it were calculated using a discount rate that is one percentage point lower (6.00%) or one percentage point higher (8.00%) than the current rate (amounts in thousands):

<u>Net pension liability</u>	<u>1% Decrease (6.00%)</u>	<u>Current discount rate (7.00%)</u>	<u>1% Increase (8.00%)</u>
June 30, 2020	\$ 848,611	260,739	(225,041)

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Net pension liability	1% Decrease (6.25%)	Current discount rate (7.25%)	1% Increase (8.25%)
June 30, 2019	\$ 864,130	292,447	(180,280)

(i) Pension Plan Fiduciary Net Position

The pension plan's fiduciary net position is determined based on the accrual basis of accounting, which is on the same basis of accounting as the Plan. Pension plan investments are recorded at fair value except for short-term investments, which are recorded at amortized cost. Benefit payments include costs as designated by the plan document, refunds of employee contributions due to terminations and member deaths, and administrative expenses.

(j) Pension Expense, Deferred Outflow of Resources, and Deferred Inflow of Resources

The Water System recognized pension expense of \$102,181 thousand and \$56,106 thousand for the years ended June 30, 2020 and 2019, respectively. Pension expense is recorded as operation and maintenance expense or construction work in progress depending on where the related payroll is charged. At June 30, 2020 and 2019, the Water System reported \$80,085 thousand and \$121,972 thousand, respectively, for deferred outflow of resources and deferred inflow of resources of \$94,913 thousand and \$137,114 thousand, respectively.

The below table summarizes the deferred inflow of resource and deferred outflow of resources related to pensions at June 30, 2020 and 2019 (amounts in thousands):

Deferred outflow of resources	June 30	
	2020	2019
Changes in proportion and differences between entity contributions and proportionate share of contributions	\$ 4,044	6,021
Difference between actual and expected experience in the total pension liability	6,947	2,761
Changes of assumptions and other inputs	69,094	113,190
Total deferred outflow of resources	\$ 80,085	121,972

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Deferred inflow of resources	June 30	
	2020	2019
Changes in proportion and differences between entity entity contributions and proportionate share of contributions	\$ 4,269	3,805
Net difference between projected and actual earnings on pension plan investments	38,142	47,721
Difference between expected and actual experience in the total pension liability	52,502	85,588
Total deferred inflow of resources	<u>\$ 94,913</u>	<u>137,114</u>

In addition to the deferred outflows noted above, there are also \$139,985 thousand and \$134,172 thousand of deferred outflows related to pension contributions made after the measurement date as of June 30, 2020 and 2019, respectively. These deferred outflows of resources are recognized as a reduction of the net pension liability in the subsequent fiscal year.

The net amount of deferred outflows of resources and deferred inflows of resources related to pensions that will be recognized in pension expense during the next five years and thereafter is as follows (in thousands):

Year	June 30	
	2020	2019
2020	\$ —	29,711
2021	17,746	10,943
2022	(29,844)	(37,416)
2023	(12,649)	(19,958)
2024	8,307	1,338
2025	1,193	240
2026	419	—
Total	<u>\$ (14,828)</u>	<u>(15,142)</u>

(8) Other Postemployment Benefit Plans

(a) General Information About the Plan

The Department provides retirees medical and dental benefits and death benefits to active and retired employees and their dependents. The retiree healthcare plan and death benefit plan are administered by the Department. The Retirement Board and the Board of Commissioners have the authority to approve provisions and obligations. Eligibility for benefits for retired employees is dependent on a combination of age and service of the participants pursuant to a predetermined formula. Any changes to these provisions must be approved by the Retirement Board and the Board.

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The retiree healthcare and death benefit plans are single-employer, defined-benefit plans. Plan assets are administered through irrevocable trusts for each fund used solely for the benefit of providing benefits to eligible participants in the Plan. Assets of the trust are legally protected from creditors and dedicated to providing postemployment reimbursement of eligible medical, dental, and vision expenses to current and eligible future retirees and their spouses in accordance with the terms of the Plan. Death benefits are provided to active and inactive employees in accordance with terms of the Plan.

The funds are administered in separate trust funds and presented as part of the retirement system financial statements. Such financial statements can be obtained from the Department of Water and Power Retirement Office, 111 North Hope, Room 357, Los Angeles, California 90012.

(b) Benefits Provided

For retiree healthcare, a medical subsidy is computed by a formula related to years of service and attained age of retirement. The subsidy limit is applied to the combined medical carrier and Medicare Part B premium but not the dental premium. For Tier 1, the monthly medical subsidy ranges from \$30.32 to \$1,962.52 depending on age and service at retirement. Tier 2, the monthly medical subsidy ranges from \$30.32 to \$981.26 depending on age and service at retirement. The monthly dental subsidy for most retirees is \$35.79. The dental subsidy is not available to pay for premiums for married and surviving spouses or domestic partners. All members hired before January 1, 2014 are Tier 1. All members hired after January 1, 2014 are Tier 2.

The death benefit plan pays death benefits to the beneficiaries of eligible employees. Generally, to be eligible for the family death benefit allowance, an employee must be a full member of the Plan and contributing to the Plan at the time of death. If death occurs after retirement, the retired member must be receiving a monthly retirement allowance from the Plan and had at least five years of department service at retirement. The Family Death Benefit plan pays a monthly allowance of \$416 to the surviving spouse of a member with minor (or disabled) children plus \$416 for each minor (or disabled) child up to a maximum monthly allowance of \$1,170. In addition, the spouse's portion will not be paid if the spouse is receiving a survivor's optional death benefit allowance or an eligible spouse allowance from the retirement plan.

The Supplemental Family Death Plan, which is part of the Death Benefit plan is optional and subject to making additional member contributions. The Supplemental Family Death Benefit Plan pays a monthly allowance of \$520 for each surviving spouse or child, in addition to the amounts payable from the Family Death Benefit Plan, subject to a maximum of \$1,066 for the additional benefits. The insured lives death benefit plan for contributing members provides death benefits to employees that die while employed by the Department. Generally, to be eligible, an employee must be a full member of the Plan and contributing to the Plan at the time of death. The benefit paid from the death benefit fund is a single sum that is equal to 14 times the member's monthly compensation with no maximum.

The insured lives death benefit plan for noncontributing members provides death benefits to employees that were employed by the Department for at least five years and death occurred after retirement. The death benefit is paid in a single sum that is equal to the lesser of 14 times the member's monthly full retirement allowance or \$20,000.

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(c) Employees Covered by Benefit Terms

At the Department's measurement date of June 30, 2019 for the June 30, 2020 reporting period, the following employees were covered by the benefit terms:

<u>Plan membership</u>	<u>Retiree healthcare</u>	<u>Death benefit</u>
Beneficiaries currently receiving benefits	—	90
Retired members currently receiving benefits	8,253	7,355
Vested terminated members not receiving benefits	—	630
Active members	10,362	10,362
Total	<u>18,615</u>	<u>18,437</u>

At the Department's measurement date of June 30, 2018 for the June 30, 2019 reporting period, the following employees were covered by the benefit terms:

<u>Plan membership</u>	<u>Retiree healthcare</u>	<u>Death benefit</u>
Beneficiaries currently receiving benefits	—	91
Retired members currently receiving benefits	8,185	7,199
Vested terminated members not receiving benefits	—	656
Active members	10,114	10,114
Total	<u>18,299</u>	<u>18,060</u>

(d) Contributions

The Board of Commissioners establishes rates for retiree healthcare plan based on an actuarially determined rate. For the years ended June 30, 2020 and 2019, the Department's average contribution rate was 9.9% and 10%, respectively, of covered employee payroll. Employees are not required to contribute to the retiree healthcare plan. Water System contributions to the retiree healthcare plan were \$36.2 million and \$33.8 million including administrative expenses of \$0.4 million and \$0.3 million for the fiscal year ended June 30, 2020 and 2019, respectively.

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The Department contributes to the death benefit fund based on actuarially determined contribution rates adopted by the board of administration. Employer contribution rates are adopted annually based on recommendations received from the Plan's actuary after the completion of the review of the death benefit fund. The employer and member contribution rates as of June 30, 2020 are as follows:

	<u>Department</u>	<u>Members</u>	
		<u>Active</u>	<u>Retired</u>
Family death benefit	\$1.36 monthly per active member	N/A	N/A
Supplemental family death benefit insured lives	N/A	\$2.25 biweekly	\$4.90 monthly
Contributing	\$0.20 per \$100 of payroll	\$1.00 biweekly	N/A
Noncontributing	\$0.96 per \$100 of monthly retirement benefit	N/A	N/A

Water System contributions to the death benefits plan were \$4.8 million including administrative expenses of \$0.5 million for the fiscal year ended June 30, 2020.

The employer and member contribution rates as of June 30, 2019 are as follows:

	<u>Department</u>	<u>Members</u>	
		<u>Active</u>	<u>Retired</u>
Family death benefit	\$1.76 monthly per active member	N/A	N/A
Supplemental family death benefit insured lives	N/A	\$2.25 biweekly	\$4.9 monthly
Contributing	\$.21 per \$100 of payroll	\$1.00 biweekly	N/A
Noncontributing	\$1.01 per \$100 of monthly retirement benefit	N/A	N/A

Water System contributions to the death benefits plan were \$2.3 million including administrative expenses of \$0.3 million for the fiscal year ended June 30, 2019.

(e) Net OPEB Liability

The Water System reported a liability of \$180 million and \$161 million for its proportionate share of the net OPEB liability for retiree healthcare plan and the death benefit plan as of the June 30, 2020 and 2019 reporting dates, respectively. The net OPEB liabilities for each of the plans was measured as of June 30, 2019 and 2018 and the total OPEB liability used to calculate the net OPEB liability was determined by actuarial valuations as of June 30, 2019 and 2018. The Water System's proportion of the net OPEB liability was based on the Water System's projected compensation for the year following the measurement date, relative to the projected compensation for the same period for both the Water

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System and the Power System. At June 30, 2020 and 2019, the Water System's proportion of the retiree healthcare plan and the death benefit plan net OPEB liabilities was 31.6% and 32.1%.

The following table shows the Water System's proportionate share of the net OPEB liability for each of the plans as of June 30, 2020 and 2019. (amounts in thousands):

	2020	2019
OPEB liability for retiree healthcare plan	\$ 146,320	123,220
OPEB liability for death benefit plans	33,333	37,472
Net OPEB Liability	\$ 179,653	160,692

The total OPEB liability in the June 30, 2019 actuarial valuations used for the Water System's June 30, 2020 financial statements was determined using the following actuarial assumptions:

	Retiree healthcare plan	Family death benefit	Supplemental death benefit	Insured lives benefit (contributing active members)	Insured lives death benefit (noncontributing members)
Cost method	Entry Age	Entry Age	Entry Age	Entry Age	Entry Age
Investment rate of return	7.00%	3.5%	3.5%	3.5%	3.5%
Inflation rate	2.75%	2.75%	2.75%	2.75%	2.75%
Real across the board salary increases	0.5%	0.5%	0.5%	0.5%	0.5%
Projected salary increase	4.50 to 10.25%	4.50 to 10.25%	4.50 to 10.25%	4.50 to 10.25%	4.50 to 10.25%
Mortality table	Pub-2010 mortality table reflected for mortality experience as of the measurement date.		—	—	—
Medical cost trends:					
Non-Medicare medical plan	6.75, graded down to 4.50% over 9 years				
Medicare medical plans	6.25, graded down to 4.50% over 7 years	—	—	—	—
Dental and Medicare Part B	4.00 and 4.50%				
Member contribution rate	None	None	\$2.25 per biweekly period or \$4.90 per month if retired	\$1.00 per biweekly payroll period	None

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	<u>Retiree healthcare plan</u>	<u>Family death benefit</u>	<u>Supplemental death benefit</u>	<u>Insured lives benefit (contributing active members)</u>	<u>Insured lives death benefit (noncontributing members)</u>
Department contribution rate	9.88%	\$1.36 per month	Any additional funds necessary to fund the benefits	\$0.20 per \$100 of payroll	\$0.96 per \$100 of monthly retirement benefit
Age and service requirements	Tier 1 – Age 60 with 5 years of service; age 55 with 10 years of service in the last 12 years; any age with 30 years of service; or receiving permanent total disability benefits from the Plan. Tier 2 – Age 60 with 5 years of continuous service with the Plan immediately prior to reaching eligibility; or age 60 with 10 years of service; or any age with 30 years of service; or receiving permanent total disability benefits from the Plan	Preretirement death of an active, full, contributing member at any age; or postretirement death of a member receiving a monthly retirement from WPERP with at least five years of service at retirement	Preretirement death of an active, full, contributing member at any age; or postretirement death of a member receiving monthly retirement from WPERP	Any age with six months of continuous service. Preretirement death of an active, full, contributing member to WPERP	Death occurs after retirement and member was receiving a retirement monthly allowance from WPERP and had at least five years of service at retirement
Per Capita Cost Development	The assumed per capita claims cost by age is calculated using age-based factors for retiree ranging from 90.5% to 123% and Spouse ranging from 71.2% to 122.6% and applying these factors to premiums (eligible spouses and survivors are not eligible for DWP dental subsidy)	—	—	—	—

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	<u>Retiree healthcare plan</u>	<u>Family death benefit</u>	<u>Supplemental death benefit</u>	<u>Insured lives benefit (contributing active members)</u>	<u>Insured lives death benefit (noncontributing members)</u>
Monthly benefit	Tier 1 – \$30.32 to \$1,962.52. Tier 2 – \$30.32 to \$981.26	\$416 per month to each surviving child plus \$416 per month to eligible spouse	\$520 per month to each surviving child plus \$520 per month to eligible spouse	A single sum distribution equal to 14 times monthly salary	A single sum distribution equal to 14 times the member's full retirement allowance up to \$20000
Participation rate	95% for medical and 95% for dental	—	—	—	—
Retirement rates	Based on 2019 experience study covering the period from July 1, 2015 through June 30, 2018				

At June 30, 2020, mortality rates were based on the Pub-2010 General Healthy Retiree Amount-Weighted Above-Median Mortality Table times 105% for males and 100% for females, projected generationally with the two-dimensional mortality improvement scale MP-2018. The actuarial assumptions used in the June 30, 2019 valuation were based on the long-term expected rate of return on OPEB plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of OPEB plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation.

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At June 30, 2020, the target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table for each fund:

Asset class	Targeted allocation	Long-term expected arithmetic real rate of return
Retiree healthcare:		
Domestic equity	30 %	6.78 %
Developed international equity	18	6.54
Fixed income	25	1.65
Real estate	8	4.60
Real return	5	2.07
Private equity	8	9.27
Covered calls	5	3.53
Cash and equivalents	1	0.25
	100 %	
	Targeted allocation	Long-term expected arithmetic real rate of return
Death benefit:		
Fixed income	96 %	1.42 %
Cash and cash equivalents	4	0.25
	100 %	

At June 30, 2020, for the retiree healthcare fund, the discount rate used to measure the total OPEB liability was 7.00% for the years ended June 30, 2020. The projection of cash flows used to determine the discount rate assumed that Department's contributions will be made at rates equal to the actuarially determined contribution rates. Based on those assumptions, the OPEB plan's fiduciary net position was projected to be available to make all projected OPEB payments for current active and inactive employees. Therefore, the long-term expected rate of return on OPEB plan investments was applied to all periods of projected benefit payments to determine the total OPEB liability.

At June 30, 2020, for the death benefit fund, the discount rate was determined to be 3.5%, which is equivalent to the 20-year municipal bond rate for the year ended June 30, 2020. The fiduciary net position of this fund was not projected to cover all future benefit payments, and thus, the 20-year municipal bond rate was used to calculate the total OPEB liability.

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The total OPEB liability in the June 30, 2018 actuarial valuations used for the Water System's June 30, 2019 financial statements was determined using the following actuarial assumptions:

	Retiree healthcare plan	Family death benefit	Supplemental death benefit	Insured lives benefit (Contributing active members)	Insured lives death benefit (Noncontributing members)
Cost method	Entry Age	Entry Age	Entry Age	Entry Age	Entry Age
Investment rate of return	7.25%	3.5%	3.5%	3.5%	3.5%
Inflation rate	3%	3%	3%	3%	3%
Real across the board salary increases	0.5%	0.5%	0.5%	0.5%	0.5%
Projected salary increase	4.50 to 10%	4.50 to 10%	4.50 to 10%	4.50 to 10%	4.50 to 10%
Mortality table	RP-2014 mortality table reflected for mortality experience as of the measurement date.		—	—	—

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	<u>Retiree healthcare plan</u>	<u>Family death benefit</u>	<u>Supplemental death benefit</u>	<u>Insured lives benefit (Contributing active members)</u>	<u>Insured lives death benefit (Noncontributing members)</u>
Medical cost trends:					
Non-Medicare medical plan	7.00, graded down to 4.5% over 10 years.	—	—	—	—
Medicare medical plans	6.50, graded down to 4.5% over 8 years.				
Dental and Medicare Part B Member contribution rate	4.5% None	None	\$2.25 per biweekly period or \$4.90 per month if retired.	\$1.00 per biweekly payroll period.	None
Department contribution rate	10.12 %	\$1.62 per month	Any additional funds necessary to fund the benefits.	\$0.22 per \$100 of payroll.	\$1.05 per \$100 of monthly retirement benefit.
Age and service requirement	Tier 1 – Age 60 with 5 years of service; age 55 with 10 years of service in the last 12 years; any age with 30 years. of service; or receiving permanent total disability benefits from the Plan. Tier 2 – Age 60 with 5 years of continuous service with the plan immediately prior to reaching eligibility; or age prior to 60 with 10 years. of service; or any age with 30 years of service; or receiving permanent total disability benefits from the Plan.	Pre-retirement death of an active, full, contributing member at any age; or Postretirement death of a member receiving a monthly retirement from WPERP with at least five years of service at retirement.	Pre-retirement death of an active, full, contributing member at any age; or Postretirement death of a member receiving monthly retirement from WPERP.	Any age with six months of continuous service. Preretirement death of an active, full, contributing member to WPERP.	Death occurs after retirement and member was receiving a retirement monthly allowance from WPERP and had at least five years of service at retirement.
Per Capita Cost Development	The assumed per capita claims cost by age is calculated using age based factors for Retiree ranging from 90.3% to 123% and Spouse ranging from 71.1% to 122.6% and applying these factors to premiums. (Eligible spouses and survivors are not eligible for DWP dental subsidy)				

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	<u>Retiree healthcare plan</u>	<u>Family death benefit</u>	<u>Supplemental death benefit</u>	<u>Insured lives benefit (Contributing active members)</u>	<u>Insured lives death benefit (Noncontributing members)</u>
Monthly benefit	Tier 1 – \$30.32 to \$1,751.18. Tier 2 \$30.32 to \$875.59.	\$416 per month to each surviving child plus \$416 per month to eligible spouse.	\$520 per month to each surviving child plus \$520 per month to eligible spouse.	A single sum distribution equal to 14 times monthly salary.	A single sum distribution equal to 14 times the member's full retirement allowance up to 20,000
Participation rate	97% for medical and 95% for dental	—	—	—	—
Retirement rates	Based on 2019 experience study covering the period from July 1, 2015 through June 30, 2018				

At June 30, 2019, mortality rates were based on the RP-2014 Healthy Annuitant Mortality Table with no age adjustments for male or females and set back one year for females, projected generationally with the two-dimensional MP-2015 projection scale. The actuarial assumptions used in the June 30, 2018 valuation were based on the long-term expected rate of return on OPEB plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of OPEB plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation.

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At June 30, 2019, the target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table for each fund:

Asset class	Targeted allocation	Long-term expected arithmetic real rate of return
Retiree healthcare:		
Domestic equity	29 %	5.76 %
Developed international equity	19	7.25
Fixed income	25	1.74
Real estate	8	4.37
Real return	5	2.39
Private equity	8	7.75
Covered calls	5	3.50
Cash and equivalents	1	(0.46)
	100 %	
	Targeted allocation	Long-term expected arithmetic real rate of return
Death benefit:		
Fixed income	96 %	(0.82)%
Cash and cash equivalents	4	(0.46)%
	100 %	

At June 30, 2019, for the retiree healthcare fund, the discount rate used to measure the total OPEB liability was 7.25%. The projection of cash flows used to determine the discount rate assumed that Department's contributions will be made at rates equal to the actuarially determined contribution rates. Based on those assumptions, the OPEB plan's fiduciary net position was projected to be available to make all projected OPEB payments for current active and inactive employees. Therefore, the long-term expected rate of return on OPEB plan investments was applied to all periods of projected benefit payments to determine the total OPEB liability.

At June 30, 2019, for the death benefit fund, the discount rate was determined to be 3.50% which is equivalent to the 20-year municipal bond rate. The fiduciary net position of this fund was not projected to cover all future benefit payments, and thus, the 20-year municipal bond rate was used to calculate the total OPEB liability.

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(f) Sensitivity of Net OPEB Liability to Changes in the Discount Rate Rates

The following table represents the net OPEB liability of the Water System, calculated using the stated discount rate assumption as well as what the Water System's net OPEB liability would be if it were calculated using a discount rate that is one percentage point lower or one percentage-point higher than the current discount rate (amounts in thousands):

	June 30, 2020		
	1% decrease	Current	1% increase
Discount rate	6.00 %	7.00 %	8.00 %
Net OPEB liability – Retiree healthcare plan	\$ 263,578	146,320	49,846
Discount rate	2.50 %	3.50 %	4.50 %
Net OPEB liability – Death benefit plan	\$ 40,154	33,333	27,908

	June 30, 2019		
	1% decrease	Current	1% increase
Discount rate	6.25 %	7.25 %	8.25 %
Net OPEB liability – Retiree healthcare plan	\$ 233,454	123,220	32,669
Discount rate	2.50 %	3.50 %	4.50 %
Net OPEB liability – Death benefit plan	\$ 44,452	37,472	31,921

(g) Sensitivity to Net OPEB Liability to Changes in Healthcare Cost Trend Rates

The following table represents the net OPEB liability of the Water System, calculated using the stated healthcare cost trend assumption as well as what the Water System's net OPEB liability would be if it were calculated using a healthcare cost trend that is one percentage point lower or one percentage point higher than the current healthcare cost trend rates (amounts in thousands):

	June 30, 2020		
	1% decrease	Current	1% increase
Net OPEB liability – Retiree healthcare plan	\$ 36,902	146,320	292,710

* Current trend rates: 7.60% graded down to 4.50% over 9 years for non-Medicare medical plan costs; 8.20% graded down to 4.50% over 7 years for Medicare medical plan costs, and 4.0% for all years for dental subsidy costs and 4.50% for all years for Medicare Part B subsidy costs

There is no trend rate assumption used in valuing the death benefit plan.

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	June 30, 2019		
	1% decrease	Current	1% increase
Net OPEB liability – Retiree healthcare plan \$	21,378	123,220	259,977

* Current trend rates: 7.00% graded down to 4.50% over 10 years for non-Medicare medical plan costs; 6.50% graded down to 4.50% over 8 years for Medicare medical plan costs, and 4.00% all years for dental and Medicare Part B subsidy costs

There is no trend rate assumption used in valuing the death benefit plan.

(h) OPEB Plan Fiduciary Net Position

Detailed information about the Plan’s fiduciary net position is available in the separately issued plan financial report. The OPEB plans’ fiduciary net positions are determined based on the accrual basis of accounting, which is on the same basis of accounting as the Plan. OPEB plan investments are recorded at fair value except for short-term investments, which are recorded at amortized cost. Benefit payments include costs designed by the plan document and administrative expenses.

(i) OPEB Expense and Deferred Outflows and Inflows of Resources Related to OPEB

For the year ended June 30, 2020, the Water System recognized OPEB expense of \$14,468 thousand and \$2,555 thousand for its proportionate share of the healthcare and death benefits plans, respectively. At June 30, 2019, the Water System recognized OPEB expense of \$12,148 thousand and \$2,843 thousand for its proportionate share of the healthcare and death benefits plans, respectively. At June 30, 2020, the Water System reported deferred outflows and inflows of resources related to OPEB Plans from the following sources (in thousands):

	Retiree healthcare plan		Death benefits plan		Total	
	Deferred outflows of resources	Deferred inflows of resources	Deferred outflows of resources	Deferred inflows of resources	Deferred outflows of resources	Deferred inflows of resources
Change in proportion and differences between employer category’s contributions	\$ 1,306	3,335	322	578	1,628	3,913
Changes of assumptions	36,979	12,639	—	3,206	36,979	15,845
Net difference between projected and actual earnings on OPEB plan investments	—	14,624	—	6	—	14,630
Differences between expected and actual experience	—	20,623	155	1,015	155	21,638
	38,285	51,221	477	4,805	38,762	56,026
Employer contributions subsequent to the measurement date	36,214	—	4,794	—	41,008	—
Totals	\$ 74,499	51,221	5,271	4,805	79,770	56,026

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For the year ended June 30, 2019, the Water System recognized OPEB expense of \$12,148 thousand and \$2,843 thousand for its proportionate share of the healthcare and death benefits plans, respectively. At June 30, 2018, the Water System recognized OPEB expense of \$19,000 thousand and \$2,767 thousand for its proportionate share of the healthcare and death benefits plans, respectively. At June 30, 2019, the Water System reported deferred outflows and inflows of resources related to OPEB Plans from the following sources (in thousands):

	Retiree healthcare plan		Death benefits plan		Total	
	Deferred outflows of resources	Deferred inflows of resources	Deferred outflows of resources	Deferred inflows of resources	Deferred outflows of resources	Deferred inflows of resources
Change in proportion and differences between employer category's contributions	\$ 1,558	1,547	384	106	1,942	1,653
Changes of assumptions	1,326	16,112	—	—	1,326	16,112
Net difference between projected and actual earnings on OPEB plan investments	—	27,529	477	—	477	27,529
Differences between expected and actual experience	—	12,104	29	1,230	29	13,334
	2,884	57,292	890	1,336	3,774	58,628
Employer contributions subsequent to the measurement date	33,518	—	2,937	—	36,455	—
Totals	\$ 36,402	57,292	3,827	1,336	40,229	58,628

Contributions after the measurement date shown above will be recognized as deferred outflows of resources in the accompanying financial statements.

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Other amounts reported as deferred outflows of resources and deferred inflows of resources related to OPEB will be recognized in OPEB expense in future reporting periods as follows (in thousands):

	For the year ended June 30, 2020		
	Retiree Healthcare Plan	Death Benefits Plan	Total
Year ending June 30:			
2021	\$ (9,095)	(650)	(9,745)
2022	(9,095)	(650)	(9,745)
2023	(3,020)	(715)	(3,735)
2024	(414)	(783)	(1,197)
2025	3,715	(682)	3,033
2026	3,585	(579)	3,006
2027	1,388	(269)	1,119
	\$ (12,936)	(4,328)	(17,264)

	For the year ended June 30, 2019		
	Retiree Healthcare Plan	Death Benefits Plan	Total
Year ending(ed) June 30:			
2020	\$ (13,917)	(16)	(13,933)
2021	(13,917)	(16)	(13,933)
2022	(13,917)	(16)	(13,933)
2023	(7,743)	(82)	(7,825)
2024	(5,096)	(151)	(5,247)
Thereafter	182	(165)	17
	\$ (54,408)	(446)	(54,854)

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(j) Healthcare Reform Legislation

The Patient Protection and Affordable Care Act (PPACA) was signed into law on March 23, 2010. One key provision of the PPACA is the assessment of the excise tax on high cost plans beginning in 2018. Under this act, a 40% excise tax applies to plans with costs exceeding certain annual thresholds for non-Medicare retirees aged 55–64 (\$11,850 for single coverage, and \$30,950 for family coverage). For all other retirees, the thresholds in 2019 and 2018 were \$10,200 for single coverage and \$27,500 for family coverage. Significant uncertainties exist regarding the impact of the excise tax on high cost plans without further regulatory guidance. Management estimated the potential impact of this tax on the liability is based on unadjusted thresholds and assuming the tax is shared between the Department and its participants in the same way that the current costs are shared. The estimated impact of the 40% excise tax provision on high cost plans beginning in 2018, under the healthcare reform, is reflected in all actuarial valuation reports after July 1, 2010.

(k) Disability Benefits

The Water System's allocated share of disability benefit plan costs and administrative expenses totaled \$5.6 million for both fiscal years 2020 and 2019. Disability benefits are paid to active employees who qualify under the Plan's provisions and terminate with the employee's retirement.

(9) Other Long-Term Liabilities

The Water System has the following other long-term liabilities:

(a) Accrued Workers' Compensation Claims

Liabilities for unpaid workers' compensation claims are recorded at their net present value when they are probable of occurrence and the amount can be reasonably estimated. The liability is actuarially determined based on an estimate of the present value of the claims outstanding and an amount for claim events incurred but not reported based on the Water System's loss experience, less the amount of claims and settlements paid to date. The discount rate used to calculate the accrued workers' compensation liability as presented in the statements of net position was 2% at both June 30, 2020 and 2019. The Power System has third-party insurance coverage for workers' compensation claims over \$600,000.

Overall indicated reserves for workers' compensation claims for both the Water System and the Power System, undiscounted, have been estimated at \$77 million and \$88 million for both June 30, 2020 and 2019, respectively. Workers' compensation claims typically take longer than one year to settle and close out. The entire discounted liability is shown as long term on the statements of net position as of June 30, 2020 and 2019.

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Changes in the Department's undiscounted liability since June 30, 2018 are summarized as follows (amounts in thousands):

		June 30		
		2020	2019	2018
Balance at beginning of year	\$	88,240	120,026	115,104
Current year claims and changes in estimates		17,635	(4,121)	34,292
Payments applied		(28,831)	(27,665)	(29,370)
Balance at end of year	\$	<u>77,044</u>	<u>88,240</u>	<u>120,026</u>

The Water System's portion of the discounted accrued workers' compensation liability is estimated at \$24 million and \$34 million for the fiscal year ended June 30, 2020 and 2019, respectively.

(10) Commitments and Contingencies

(a) Purchase Water Commitments

As a member of the Metropolitan Water District (Metropolitan), the Water System purchases water from Metropolitan pursuant to water supply purchase orders entered into with Metropolitan for specific periods. In January 2015, the Water System and Metropolitan executed a new Purchase Order for Imported Water Supply Agreement (the Purchase Order Agreement), which requires the Water System to purchase at least 2,033,130 acre-feet of water over a 10-year period commencing on January 1, 2015 and expiring on December 31, 2024. Some of the key terms of the Purchase Order Agreement include the following: (a) the Water System's annual maximum Tier 1 allocation of water from Metropolitan is 335,663 acre-feet per year, or 3,356,630 acre-feet for the 10-year term of the Purchase Order Agreement; (b) any obligation to pay Metropolitan's Tier 2 supply rate will only be assessed if a member agency exceeds its total 10-year Tier 1 allocation. Under the previous purchase order agreement, Tier 2 costs were assessed on an annual basis, with no ability for member agencies to carry over unused Tier 1 allocation from one year to the next; (c) opportunity to reset the base period demand using a five-year rolling average; and (d) an appeals process for agencies with unmet purchase commitments has been established. This will allow each acre-foot of unmet purchase order commitment to be reduced by the amount of production from a local resource project that commences operation on or after January 1, 2014, which will allow member agencies who successfully develop local supplies, not to be charged if production of these supplies negatively impacts their minimum purchase order commitment. As of June 30, 2020, the Water System has purchased 1,210,379 acre-feet from Metropolitan under the current Purchase Order Agreement. The Water System expects to fulfill the remaining commitment of 822,751 acre-feet of water from Metropolitan over the next 4.5 years, which is estimated to cost \$924 million, or approximately \$205 million per year.

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(b) Environmental Liabilities

The Water System follows GASB Statement No. 49, *Accounting and Financial Reporting for Pollution and Remediation Obligations*. This statement addresses accounting and financial reporting standards for pollution (including contamination) remediation obligations, which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities such as site assessments and cleanups. The scope of the statement excludes pollution prevention or control obligations with respect to current operations, and future pollution remediation activities that are required upon retirement of an asset, such as landfill closure and postclosure care and nuclear power plant decommissioning.

The Water System estimates its environmental liabilities using the expected cash flow method as required by GASB 49. This method estimates the current value of outlays expected to be incurred measured as a sum of the probability weighted amounts in a range of possible estimated amounts. The Water System's environmental liabilities relate primarily to its underground storage tanks. The Water System is working with the Los Angeles Regional Water Quality Control Board and the Lahontan Regional Quality Control Board which have jurisdiction over these sites. The Water System's estimated liability for these sites is \$11.3 million and \$12.4 million for the years ended June 30, 2020 and 2019, respectively, and includes remediation and ongoing operation and maintenance costs where estimable. This liability is recorded as part of the Water System's accrued expenses. These estimates are reviewed and updated annually.

(c) Surface Water Treatment Rule

The State of California Surface Water Treatment Rule (SWTR) imposed increased filtration requirements at any open distribution reservoir exposed to surface water runoff. The Water System had four major reservoirs in its system subject to SWTR: Upper and Lower Hollywood, Lower Stone Canyon, and EnciNo. To comply with SWTR, the Water System designed projects to remove these reservoirs from regular service through construction of larger pipelines and alternate covered storage facilities.

The Hollywood Water Quality Improvement Project was completed in July 2002. Upper and Lower Hollywood Reservoirs were removed from service and functionally replaced by two 30 million gallon tanks and additional pipelines. Construction of the Encino Water Quality Improvement Project was completed in December 2007. Construction of the Lower Stone Canyon Water Quality Improvement Project was completed in November 2008. Management believes the Water System is now in compliance with the SWTR.

(d) Stage 2 Disinfectants and Disinfection Byproduct Rule

In January 2006, the Environmental Protection Agency (EPA) published the Stage 2 Disinfectants and Disinfection Byproduct Rule (Stage 2 DBP Rule) in the federal register. The Stage 2 DBP Rule strengthens public health protection for customers by tightening compliance monitoring requirements for two groups of disinfection by products (DBPs): trihalomethanes, and haloacetic acids. DBPs form when naturally occurring materials in water (e.g., decomposing plant material) combine with chemicals added to disinfect the water. DBPs are associated with cancer.

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In order to comply with the requirements of the Stage 2 DBP Rule, the Water System changed its primary disinfectant from chlorine to chloramines. In order to convert to chloramines, the Department constructed an ultraviolet filtration plant, two chloramination stations, three ammoniation stations, two chlorination stations, and has and will continue to install mixers in tanks and reservoirs. The Water System achieved compliance with the Stage 2 DBP Rule before the April 1, 2014 compliance date. Additional treatment facilities will be constructed, as groundwater sources are improved and/or expanded. The cost of Stage 2 DBP compliance-related engineering studies and construction activities is expected to be approximately \$446.2 million at completion. The actual expenditures to date are \$353.5 million.

(e) Long-Term 2 Enhanced Surface Water Treatment Rule

In January 2006, the EPA published the Long Term 2 Enhanced Surface Water Treatment Rule (LT2) in the federal register. The LT2 builds upon the Safe Drinking Water Act and other earlier water quality rules to strengthen protection against microbial contaminants, especially cryptosporidium. Cryptosporidium is a significant concern in drinking water because it contaminates most watersheds used for the collection of drinking water and can cause gastrointestinal illness. Five of the Department's six open reservoirs are now compliant under the LT2, with the remaining reservoir to be brought into compliance through the completion of the Los Angeles Reservoir Ultraviolet Treatment Plant. Santa Ynez, Elysian, and Upper Stone Canyon Reservoirs were covered. Silver Lake and Ivanhoe Reservoirs were removed from service. Construction of an ultraviolet treatment plant at Los Angeles Reservoir is 89 percent complete. The cost of LT2 compliance-related engineering studies and construction activities is expected to reach \$1.555 billion at completion. The actual cost spent to date has been \$1.358 billion.

(f) Owens Lake

Historically, the Owens River was the main source of water for Owens Lake. Diversion of water from the river, first by farmers in the Owens Valley and then by the City, resulted in the lake drying up. The exposed lakebed became a significant source of particulate matters of 10 micrometers or less in diameter (PM10), causing the U.S. EPA to classify the southern Owens Valley as a serious nonattainment area for PM10 in 1991. The EPA required the Great Basin Unified Air Pollution Control District (District) to prepare a State Implementation Plan (SIP) to bring the region into compliance with the National Ambient Air Quality Standard (NAAQS). In 1998, the District adopted the first SIP for attainment of the NAAQS to bring the region into compliance.

In the intervening years, the Water System has constructed facilities at the Lake in Phases responding to a series of supplemental control requirements. In November 2014, the Department reached an agreement with the District. The agreement was memorialized in a stipulated judgment that provides several benefits to the Department, including provisions: (1) permitting the use of less water intensive and completely waterless measures to control dust at the lakebed, resulting in more water available for customer use; (2) limiting the City's liability for dust mitigation to no more than 53.4 square miles; (3) forming an Owens Lake Scientific Advisory Panel; and (4) addressing the discovery of Native American artifacts on or around the lakebed. In accordance with the agreement, the previous SIP was revised and calls for the region to be in attainment by the end of 2017.

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The Water System completed construction of the Owens Lake Dust Mitigation Program – Phase 9/10 Project by the compliance deadline of December 31, 2017. The Phase 9/10 Project entailed mitigating dust emissions from an additional 3.62 square miles of Owens Lake playa through use of Gravel Blanket, Managed Vegetation, and Shallow Flooding Best Available Control Measures at a cost of \$268 million. At completion of Phase 9/10, the Department has now controlled dust emission on 48.6 square miles of Owens Lake playa resulting in 99.3% overall reduction in PM10 emissions. All improvements made to Owens Lake as part of dust mitigation efforts are recorded as Utility Plant in the year made.

(g) Litigation

A number of claims and suits are pending against the Water System for alleged damages to persons and property and for other alleged liabilities arising out of its operations. In the opinion of management, any ultimate liability, which may arise from these actions, is not expected to materially impact the Water System's net position, changes in net position, or cash flows.

(h) Risk Management

The Water System is subject to certain business risks common to the utility industry. The majority of these risks are mitigated by external insurance coverage obtained by the Water System. For other significant business risks, however, the Water System has elected to self-insure. Management believes that exposure to loss arising out of self-insured business risks will not materially impact the Water System's net position, changes in net position, or cash flows.

(i) Credit Risk

Financial instruments, which potentially expose the Water System to concentrations of credit risk, consist primarily of retail receivables. The Water System's retail customer base is concentrated among commercial, industrial, residential, and governmental customers located within the city. Although the Water System is directly affected by the City's economy, management does not believe significant credit risk exists at June 30, 2020 and 2019, except as provided in the allowance for losses. The Water System manages its credit exposure by requiring credit enhancements from certain customers and through procedures designed to identify and monitor credit risk.

(j) FBI Investigation

In July 2019, the Federal Bureau of Investigation began conducting an investigation of the Department and the Office of the City Attorney. The Department is cooperating fully with the investigators. The Department has been requested by the investigating agency to exercise confidentiality with respect to the investigation. The Department can generally state that the search warrants served by the Federal Bureau of Investigation on the Department and the Office of the City Attorney relate to issues that have arisen over the class action litigation and settlement regarding the Department's billing system and the lawsuit against PricewaterhouseCoopers. Based on the Department's understanding of the nature of the investigation and the current status of the lawsuits relating to the new billing system, the Department does not believe that the investigation or the billing-system-related lawsuits will have a material adverse effect on the Department's operations or financial position.

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(11) Subsequent Events

(a) Bond Sale

In July 2020, the Water System issued \$204.3 million of revenue bonds, 2020 Series A. The net proceeds of \$263.5 million, including a \$59.2 million issue premium net of underwriter's discount, were used to refund a portion of the Water System 2010 Series A, refund certain DWSRF loans, and to fund capital improvements.

In September 2020, the Water System issued \$120.5 million of revenue bonds, 2020 Series B. The net proceeds of \$151.5 million, including a \$31.0 million issue premium net of underwriter's discount, were used to refund a portion of the Water System 2001 Series B and refund all of the outstanding Water System 2003 Series B.

(b) July 2020 Variable Rate Bond Standby Agreement Expiration

In July 2020, the Water System Variable Rate Revenue Bonds, 2019 A Subseries A-3, amounting to \$29.8 million, matured on July 1, 2020. This resulted in the standby agreement supporting the bonds to expire at the maturity of the bonds.

**DEPARTMENT OF WATER AND POWER
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Required Supplementary Information

June 30, 2020

(Unaudited)

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

Last 10 years*

(Amounts in thousands other than percentages)

	<u>2020</u>	<u>2019**</u>	<u>2018</u>	<u>2017</u>	<u>2016</u>	<u>2015</u>
Water System's proportion of the net pension liability collective	31.610 %	32.100 %	31.748 %	31.892 %	32.603 %	32.344 %
Water System's proportionate share of the collective net pension liability	\$ 260,739	292,447	426,444	698,878	373,024	411,485
Water System's covered-employee payroll	325,018	306,316	283,300	274,851	273,607	265,192
Water System's proportionate share of the collective net pension liability as a% of covered payroll	80.22 %	95.47 %	150.53 %	254.27 %	136.34 %	155.16 %
Pension plan's fiduciary net position as a percentage of total pension liability	94.03 %	93.10 %	89.39 %	82.17 %	89.80 %	84.41 %

* The Water System implemented GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*—an amendment to GASB Statement 27, effective July 1, 2013; therefore, no information is available for the measurement periods prior to June 30, 2013.

** The measurement period for each year presented is on a one-year lag and thus the measurement periods are June 30, 2014–2018 for the Water Systems' fiscal years June 30, 2015–2020.

See accompanying independent auditors' report.

**DEPARTMENT OF WATER AND POWER
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Required Supplementary Information

June 30, 2020

(Unaudited)

Schedule of the Department's Pension Contributions *

Last 10 fiscal years

(Amounts in thousands other than percentages)

Reporting date for Water System June 30 ⁽¹⁾	Actuarially determined contributions ⁽²⁾	Contributions in relation to the actuarially required contributions ⁽³⁾	Contributions deficiency (excess)	Covered payroll	Contributions as a percentage of covered employee payroll
2020	\$ 424,375	422,017	2,358	1,130,066	37.34 %
2019	408,750	410,165	(1,415)	1,028,212	39.89
2018	425,512	433,413	(7,901)	953,636	45.45
2017	403,780	391,717	12,063	892,331	43.90
2016	368,600	362,360	6,240	861,819	42.05
2015	387,465	376,902	10,563	839,213	44.91
2014	387,824	384,266	3,558	819,924	46.87
2013	376,668	368,426	8,242	817,421	45.07
2012	336,875	321,689	15,186	819,924	39.23
2011	304,432	286,699	17,733	791,760	36.21

(1) The measurement date under GASB Statement No. 68 is on a one-year lag.

(2) All actuarially determined contributions through June 30, 2014 were determined as the annual requirement under GASB Statements No. 25 and No. 27.

(3) Contributions do not include administrative expenses paid to the Plan.

* Information in this schedule was not separately available for the Water System.

See accompanying independent auditors' report.

**DEPARTMENT OF WATER AND POWER
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Required Supplementary Information

June 30, 2020

(Unaudited)

Schedule of Water System's Proportionate Share of the Net OPEB Liability – Retiree Healthcare Plan

Last 10 fiscal years

(Amounts in thousands other than percentages)

Reporting date of employer	Measurement date	Proportionate share of net OPEB liability	Proportionate share of net OPEB liability	Projected compensation	Covered payroll	Proportionate share of the net OPEB liability as a percentage of covered payroll	Plan's fiduciary net position as a percentage of the total OPEB liability
June 30, 2017	June 30, 2016	31.89 %	\$ 204,468	\$ 296,242	274,852	74.39 %	72.53 %
June 30, 2018	June 30, 2017	31.75	138,297	314,885	283,300	48.82	81.44
June 30, 2019	June 30, 2018	32.12	123,220	344,835	306,316	40.23	84.46
June 30, 2020	June 30, 2019	31.61	146,320	360,944	325,015	45.02	82.75

See accompanying independent auditors' report.

**DEPARTMENT OF WATER AND POWER
OF THE CITY OF LOS ANGELES
WATER SYSTEM**

Required Supplementary Information

June 30, 2020

(Unaudited)

Schedule of Water System's Proportionate Share of the Net OPEB Liability – Death Benefit Plan

Last 10 fiscal years

(Amounts in thousands other than percentages)

Reporting date of employer	Measurement date	Proportionate share of net OPEB liability	Proportionate share of net OPEB liability	Projected compensation	Covered payroll	Proportionate share of the net OPEB liability as a percentage of covered payroll	Plan's fiduciary net position as a percentage of the total OPEB liability
June 30, 2017	June 30, 2016	31.89 %	\$ 37,542	\$ 296,242	274,852	13.66 %	19.32 %
June 30, 2018	June 30, 2017	31.75	37,852	314,885	283,300	13.36	18.79
June 30, 2019	June 30, 2018	32.12	37,472	344,835	306,316	12.23	18.91
June 30, 2020	June 30, 2019	31.61	33,333	360,944	325,015	10.26	21.46

See accompanying independent auditors' report.

**DEPARTMENT OF WATER AND POWER
OF THE CITY OF LOS ANGELES
WATER SYSTEM**

Required Supplementary Information

June 30, 2020

(Unaudited)

Schedule of Department Contributions – Retiree Healthcare Plan*

Last 10 fiscal years

(Amounts in thousands other than percentages)

Reporting date for the Water System June 30	Actuarially determined contributions ⁽¹⁾	Contributions in relation to the actuarially required contributions ⁽²⁾	Contributions deficiency (excess)	Covered payroll	Contributions as a percentage of covered employee payroll
2020	\$ 95,375	109,401	(14,026)	1,130,066	9.68 %
2019	80,851	101,595	(20,744)	1,028,212	9.88
2018	85,339	95,233	(9,894)	953,635	9.99
2017	93,920	90,310	3,610	892,332	10.12
2016	61,971	79,896	(17,925)	861,819	9.27
2015	70,748	78,497	(7,749)	839,214	9.35
2014	58,453	74,106	(15,653)	819,924	9.04
2013	36,908	67,563	(30,655)	817,421	8.27
2012	40,095	101,721	(61,626)	805,607	12.63
2011	66,188	140,133	(73,945)	791,760	17.70

⁽¹⁾ All actuarially determined contributions through June 30, 2016 were determined as the annual requirement under GASB Statements No. 43 and No. 45.

⁽²⁾ Contributions do not include administrative expenses paid to the Plan.

* Information in this schedule was not separately available for the Water System.

See accompanying independent auditors' report.

**DEPARTMENT OF WATER AND POWER
OF THE CITY OF LOS ANGELES
WATER SYSTEM**

Required Supplementary Information

June 30, 2020

(Unaudited)

Schedule of Department Contributions – Death Benefit Plan **

Last 10 fiscal years

(Amounts in thousands other than percentages)

Reporting date for the Water System June 30	Actuarially determined contributions ⁽¹⁾	Contributions in relation to the actuarially required contributions	Contributions deficiency (excess)	Covered payroll	Contributions as a percentage of covered employee payroll
2020	\$ 13,335	13,300	35	1,130,066	1.18 %
2019	7,260	7,260	—	1,028,212	0.71
2018	7,137	7,137	—	953,636	0.75
2017	7,138	7,138	—	892,332	0.80

⁽¹⁾ Contributions do not include administrative expenses paid to the Plan.

** Information in this schedule was not available separately for the Water System.

See accompanying independent auditors' report.