Department of Water Resources
Electric Power Fund
Financial Statements

March 31, 2008

Department of Water Resources Electric Power Fund
Index

USING THIS REPORT

This discussion and analysis is designed to assist the reader in focusing on significant financial issues and activities and to identify any significant changes in financial position of the Department of Water Resources Electric Power Fund (the Fund), which is administered by the California Department of Water Resources (DWR). Readers are encouraged to consider the information presented in conjunction with the financial statements as a whole, which follows *Management's Discussion and Analysis*. This discussion and analysis and the financial statements do not relate to DWR's other governmental and proprietary funds.

The basic financial statements include three required statements, which provide different views of the Fund. They are: the statement of net assets, the statement of revenues, expenses and changes in net assets, and the statement of cash flows. These statements provide current and long-term information about the Fund and its activities. These financial statements report information using accounting methods similar (although not identical) to those used by private sector companies. The statement of net assets includes all assets and liabilities as of a specified date. The statement of revenues, expenses and changes in net assets presents all revenues, expenses, and changes in net assets for a specific period. The statement of cash flows reports cash receipts, disbursements and the net change in cash resulting from three principal types of activities: operating, financing and investing. In order for the basic financial statements to be complete, they must be accompanied by a complete set of footnotes. The notes to the financial statements provide disclosures which are required to conform with generally accepted accounting principles. The Fund is required to follow accounting standards promulgated by the Governmental Accounting Standards Board.

This report should be read in conjunction with the Fund's June 30, 2007 audited financial statements.

BACKGROUND

The Fund was established in January 2001 through legislation to assist mitigation of the effects of a statewide energy supply emergency. DWR has the authority to secure and retain title to power for resale to end use customers of the State's investor owned utilities (IOUs) under power supply contracts entered into prior to January 1, 2003. The scheduling, dispatch, and certain other administrative functions for the long-term contracts are performed by the IOUs. However, DWR retains the legal and financial responsibility for the contracts until such time as there is complete assignment of the contracts to the IOUs and release of DWR. DWR is entitled to recover revenue requirements for authorized activities, including but not limited to debt service, the costs of power purchases, other expenses and reserves.

STATEMENTS OF NET ASSETS

The Fund's assets, liabilities and net assets as of March 31, 2008 and June 30, 2007 are summarized as follows (in millions):

	March 31, 2008	June 30, 2007
Long-term restricted cash, equivalents and investments	$ 1,465	$ 1,542
Recoverable costs, net of current portion	5,920	6,503
Restricted cash and investments:		
Operating and priority contract accounts	1,290	1,167
Bond charge collection and bond charge payment accounts	1,013	549
Recoverable costs, current portion	577	610
Interest receivable	43	41
Other assets	137	91
Total assets	$ 10,445	$ 10,503
Net assets	$ -	$ -
Long-term debt, including current portion	9,982	9,995
Other current liabilities	463	508
Total capital and liabilities	$ 10,445	$ 10,503

Long-Term Restricted Cash and Investments

The Operating Reserve Account balance decreased by $64 million to $548 million effective January 1, 2008, due to lower forecasted operating expenses for calendar 2008. The amount is determined in accordance with the bond indenture and is equal to twelve percent of projected annual operating expenses of the Fund for calendar year 2008 as forecast in DWR's 2008 supplemental revenue requirement determination.

With the implementation of the calendar year 2008 supplemental revenue requirement and the refunding transaction described in the Long-Term Debt section below, the Debt Service Reserve Account balance was reduced by a net $13 million to $917 million during the three month period ended March 31, 2008. In accordance with the bond indenture, the current balance is equal to the maximum annual debt service on the outstanding bonds.

Recoverable Costs, Net of Current Portion

Long-term recoverable costs consist of costs that are recoverable through future billings. The $583 million net decrease in long-term recoverable costs during the nine month period ended March 31, 2008 is a combination of 1) operating revenues exceeding operating expenses by $141 million, and 2) bond charge revenue exceeding interest expense and costs of issuance by $442 million.

Restricted Cash and Investments

The Operating and Priority Contract Accounts increased by $123 million during the nine month period ended March 31, 2008. The balance at March 31, 2008 is $58 million higher than forecast in the 2008 supplemental revenue requirement. Higher than expected balances result from a combination of lower than expected power costs through the last half of calendar 2007 and higher than expected receipts from ratepayers during the first three months of calendar 2008.

The Bond Charge Collection and Bond Charge Payment Accounts increased by $464 million in the nine month period ended March 31, 2008 in anticipation of the May 1, 2008 $470 million principal payment and semi-annual interest payment on outstanding fixed rate bonds.

From the dates of issuance of the revenue bonds through March 31, 2008, the balances in each of the restricted cash and investments accounts met or exceeded balances required by the Bond Indenture.

Recoverable Costs, Current Portion

The current portion of recoverable costs reflects billings to IOU customers that have not yet been collected and amounts due for surplus sales of energy and gas. The current portion of recoverable costs at March 31, 2008 is $33 million lower than at June 30, 2007. This decrease is primarily attributable to lower volumes of power sold to IOU customers in the first three months of 2008 due to the expiration of a one long term contract and the renegotiation of another long term contract from fixed volumes to peaking capacity. The decreased volumes associated with the power sales to IOU customers were partially offset by higher per unit prices received on surplus sales of power and natural gas.

Other Assets

DWR purchases natural gas as fuel for the production of power under the terms of certain power purchase contracts and maintains a brokerage account with a national brokerage firm in order to hedge natural gas costs. Assets in this account are classified as other assets on the Statements of Net Assets.

Other assets increased by $46 million in the nine months ended March 31, 2008 to $137 million. Natural gas prices increased substantially in the first three months of calendar 2008, increasing the value of existing hedge investments. At March 31, 2008, other assets consisted of money market obligations, US Treasury bills, and government bonds valued at $42 million and financial options valued at $95 million.

Long-Term Debt

Prior to March 2008 DWR had $500 million in auction rate debt and $1.325 billion in other variable rate debt that was insured by insurance companies that have recently been downgraded from their former AAA credit ratings. In March 2008 DWR began a process to refund this debt by the issuance of a combination of fixed rate debt and variable rate debt enhanced by direct pay letters of credit.

In March 2008, DWR issued Series H fixed rate revenue bonds with a par value of $1.007 billion. The Series H bonds were sold with a net premium of $43 million. DWR incurred costs of $12 million for the issuance of the Series H bonds.

The proceeds of the Series H bonds, along with $21 million of funds released from the Bond Charge Payment Account and the Debt Service Reserve Account, were used to redeem $250 million from Series C, $500 million from Series D auction rate bonds, and $300 million from Series G plus interest at various dates through April 30, 2008. For purposes of financial reporting, the refunded bonds are considered to be defeased as of March 31, 2008 and the related liabilities have been removed from the financial statements.

Subsequent to March 31, 2008, DWR issued three additional revenue bond series to redeem the remaining $775 million ($150 million from Series C and $625 million from Series G) in variable rate debt insured by bond insurance companies that recently lost their AAA credit ratings. All the refunded bonds were redeemed by May 8, 2008.

Amortization of premium and losses on defeasance amounted to $13 million for the nine months ended March 31, 2008.

Other Current Liabilities

Accounts payable reflect one month's accrual for power and fuel purchases. At March 31, 2008 accounts payable are $93 million lower than at June 30, 2007 due to the expiration of a long term contract and the renegotiation of another long term contract from fixed price and volume to peaking capacity substantially lowering monthly power costs after December 2007. Also contributing to the difference are seasonally lower volumes and capacity payments for other existing contracts.

Accrued interest payable increased by $48 million in anticipation of the upcoming semi-annual interest payment on outstanding fixed rate bonds on May 1, 2008.

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

The Fund's activities for the three and nine months ended March 31, 2008 and 2007 are summarized as follows (in millions):

	Three months ended March 31		Nine months ended March 31	
	2008	**2007**	**2008**	**2007**
Revenues:				
Power charges	$ 925	$ 1,061	$ 3,181	$ 3,475
Surplus sales	104	114	318	306
Bond charges	202	197	628	636
Interest income	39	52	127	124
Total revenues	1,270	1,424	4,254	4,541
Expenses:				
Power purchases	931	1,083	3,350	3,606
Energy settlements	(6)	(3)	(15)	(17)
Interest expense	92	105	301	313
Cost of issuance	12	-	12	-
Other expenses	9	6	23	21
Recovery of recoverable costs	232	233	583	618
Total expenses	1,270	1,424	4,254	4,541
Net income	-	-	-	-
Net assets, beginning of the period	-	-	-	-
Net assets, end of period	$ -	$ -	$ -	$ -

Power Charges

Power charges decreased by $294 million in the nine months ended March 31, 2008 compared to the same nine month period ending March 31, 2007. Because of one contract termination and one contract renegotiation, the volume of power sold was 3% lower for the nine month period in 2008. In addition, the average remittance rate in 2008 is 6% lower than in the same period in 2007. The remittance rates are lower as a result of 1) anticipated lower fuel costs, and 2) the ability of DWR to reduce remittance rates in calendar year 2007 to purposefully reduce cash while maintaining required minimum balances in the Operating, Priority Contract, and Operating Reserve Accounts in excess of bond indenture requirements.

Surplus Sales

Surplus sales of energy and natural gas in the nine month period ended March 31, 2008 are $12 million higher than in the same period ended March 31, 2007. The dollar value of sales of excess natural gas in the nine months ended March 31, 2008 was higher than in the same period in the prior year, reflecting higher market prices since the beginning of calendar year 2008. Also contributing to the increase were 20% higher surplus energy prices per megawatt hour during the nine month period ended March 31, 2008 compared to the same period in 2007.

Bond Charges

Bond charges for the nine months ended March 31, 2008 are $8 million lower than the same period ended March 31, 2007, due to slightly lower remittance rates. Bond Charges for the period were adequate to meet all debt service requirements and maintain bond indenture required account balances in the Bond Charge Collection, Bond Charge Payment, and Debt Service Reserve Accounts.

Interest Income

Interest income for the nine months ended March 31, 2008 is $3 million higher than the interest income for the same period in 2007 and is attributable to higher balances earning interest offsetting lower rates received on investments in the State of California Investment Pooled Money Investment Account-Surplus Money Investment Fund.

Power Purchases

Power costs are $256 million lower in the nine months ended March 31, 2008 than in the same period in 2007. The lower costs are primarily due the expiration of one long term contract and the renegotiation of another long term contract that substantially lowered costs after December 2007. Hedging costs and amounts needed to meet margin calls also decreased in the period ended March 31, 2008, as the prior year was affected by the sharp decline in gas prices from levels hedged during the 2005 hurricane season. The lower contract costs were partially offset by higher prices for natural gas in the nine month period ending March 31, 2008 than in the same period in 2007.

Energy Settlements

The Fund received bankruptcy court distributions totaling $11 million for the nine months ending March 31, 2008 as part of the 2005 Enron Corp. energy settlement. The Fund received $4 million in other settlements in the period.

Interest Expense

Interest expense in the nine months ended March 31, 2008 is $12 million lower than amounts incurred in the same period in 2007 due to lower total debt outstanding and lower interest costs on the portion of variable rate debt unhedged with interest rate swaps as the average interest rate declined.

Cost of Issuance

During the nine month period ended March 31, 2008, the Fund incurred $12 million in costs for the issuance of the Series H bonds. These costs include underwriters' fees and bond insurance.

Other Expenses

Other expenses are $2 million higher in the nine months ended March 31, 2008 than in the same period in 2007, generally due to increased charges for services to the power supply program by other State agencies.

Recovery of Recoverable Costs

The individual components of the recovery of recoverable costs are as follows for the three and nine months ended March 31, 2008 and 2007 (in millions):

	Three months ended March 31		Nine months ended March 31	
	2008	**2007**	**2008**	**2007**
Operations	$ 95	$ 89	$ 141	$ 171
Debt service and related costs	137	144	442	447
	$ 232	$ 233	$ 583	$ 618

Operations
There was a recovery of $141 million for the nine months ended March 31, 2008 reflecting lower than expected energy costs offsetting DWR's planned decrease in power charge remittance rates for the nine month period to purposefully lower cash balances while staying within bond indenture requirements.

Debt Service and Related Costs
The recovery of debt service and related costs of $442 for the nine months ended March, 31 2008 is $5 million lower than in 2007. The recovery is comprised of the difference between bond charges and interest income less interest expense and cost of issuance of bonds.

Department of Water Resources Electric Power Fund
Statements of Net Assets
March 31, 2008 and June 30, 2007 (in millions)

	March 31, 2008	June 30, 2007
Assets		
Long-term assets:		
Restricted cash, equivalents and investments:		
Operating Reserve Account	$ 548	$ 612
Debt Service Reserve Account	917	930
Recoverable costs, net of current portion	5,920	6,503
Total long-term assets	7,385	8,045
Current assets:		
Restricted cash and investments:		
Operating and Priority Contract Accounts	1,290	1,167
Bond Charge Collection and Bond Charge Payment Accounts	1,013	549
Recoverable costs, current portion	577	610
Interest receivable	43	41
Other assets	137	91
Total current assets	3,060	2,458
Total assets	$ 10,445	$ 10,503
Capitalization and Liabilities		
Capitalization:		
Net assets	$ -	$ -
Long-term debt:		
Revenue bonds	9,499	9,508
Total capitalization	9,499	9,508
Current liabilities:		
Current portion of long-term debt	483	487
Accounts payable	360	453
Accrued interest payable	103	55
Total current liabilities	946	995
Commitments and contingencies (Note 5)		
Total capitalization and liabilities	$ 10,445	$ 10,503

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

Department of Water Resources Electric Power Fund
Statements of Revenues, Expenses and Changes in Net Assets
For the three and nine months ended March 31, 2008 and 2007 (in millions)

	Three months ended March 31		Nine months ended March 31	
	2008	**2007**	**2008**	**2007**
Operating revenues:				
Power charges	$ 925	$ 1,061	$ 3,181	$ 3,475
Surplus sales	104	114	318	306
Total operating revenues	1,029	1,175	3,499	3,781
Operating expenses:				
Power purchases	931	1,083	3,350	3,606
Energy settlements	(6)	(3)	(15)	(17)
Administrative expenses	9	6	23	21
Recovery of recoverable operating costs	95	89	141	171
Total operating expenses	1,029	1,175	3,499	3,781
Income from operations	-	-	-	-
Bond charges	202	197	628	636
Interest income	39	52	127	124
Interest expense	(92)	(105)	(301)	(313)
Cost of issuance	(12)	-	(12)	-
Recovery of recoverable debt service and related costs	(137)	(144)	(442)	(447)
Net income	-	-	-	-
Net assets, beginning of period	-	-	-	-
Net assets, end of period	$ -	$ -	$ -	$ -

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

Department of Water Resources Electric Power Fund
Statements of Cash Flows
For the nine months ended March 31, 2008 and 2007 (in millions)

	2008	2007
Cash flows from operating income:		
Receipts:		
Power charges	$ 3,171	$ 3,557
Surplus sales	323	285
Energy settlements	15	17
Payments for power purchases and other expenses	(3,512)	(3,722)
Net cash (used in) provided by operating activities	(3)	137
Cash flows from non-capital financing activities:		
Receipt of bond charges	666	672
Interest payments	(266)	(276)
Proceeds from issuance of revenue bonds	1,050	-
Cost of issuance net of underwriters discount	(12)	-
Defeasance of revenue bonds	(1,050)	-
Net cash provided by non-capital financing activities	388	396
Cash flows from investing activities:		
Interest received	125	108
Termination of guaranteed investment contract	150	-
Net cash provided by investing activities	275	108
Net increase in cash and equivalents	660	641
Restricted cash and equivalents, beginning of period	2,658	2,365
Restricted cash and equivalents, end of period	$ 3,318	$ 3,006
Restricted cash and equivalents included in:		
Operating Reserve Account	$ 548	$ 612
Debt Service Reserve Account (a component of the total of $917 and $930 each at March 31, 2008 and 2007)	467	330
Operating and Priority Contract Accounts	1,290	1,119
Bond Charge Collection and Bond Charge Payment Accounts	1,013	945
Restricted cash and equivalents, end of period	$ 3,318	$ 3,006
Reconciliation of operating income to net cash (used in) provided by operating activities:		
Income from operations	$ -	$ -
Changes in net assets and liabilities to reconcile operating income to net cash (used in) provided by operations:		
Recoverable costs	90	83
Accounts payable	(93)	54
Total adjustments	(3)	137
Net cash (used in) provided by operating activities	$ (3)	$ 137

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

1. Reporting Entity

In January 2001, the Governor of California issued an emergency proclamation directing the Department of Water Resources (DWR) to enter into contracts and arrangements for the purchase and sale of electric power to assist in mitigating the effect of a statewide energy supply emergency.

The Department of Water Resources Electric Power Fund (a component unit of the State of California) (the Fund), administered by DWR, was established in January 2001 through legislation adding Division 27 to the California Water Code.

In January 2001, DWR began selling electricity to approximately ten million investor owned utility (IOU) retail customers. DWR currently purchases power from wholesale suppliers under contracts entered into prior to January 1, 2003 and delivers the power to the customers through the transmission and distribution systems of the IOUs. Payments from the customers are collected for DWR by the IOUs pursuant to servicing arrangements approved and/or ordered by the California Public Utilities Commission.

Basis of Presentation

The Fund is accounted for as an enterprise fund and is financed and operated in a manner similar to that of a private business enterprise. The Fund uses the economic resources measurement focus and the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. As allowed by governmental accounting standards, the Fund has elected not to apply statements and related interpretations issued by the Financial Accounting Standards Board after November 30, 1989. The Fund is accounted for with a set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues and expenses.

The financial statements of the Fund are intended to present the financial position, and the changes in financial position and cash flows, where applicable, of only that portion of the business-type activities and major funds of the State of California that is attributable to the transactions of the Fund. They do not purport to, and do not, present fairly the financial position of the State of California and the changes in its financial position and its cash flows, where applicable, in conformity with accounting principles generally accepted in the United States of America.

2. Restricted Cash and Investments

The State of California has a deposit policy for custodial credit risk. As of March 31, 2008, $14 million of the Fund's cash balances were uninsured and uncollateralized.

As of March 31, 2008, the Fund had the following investments (in millions):

Investment	Maturity	Amount
State of California Pooled Money Investment Account - Surplus Money Investment Fund (SMIF)	6.7 months average	$ 3,277
Cash		41
		3,318
Guaranteed investment contracts	May 1, 2022	350
Forward purchase agreement	May 1, 2008	100
		$ 3,768

The Fund's investments in the guaranteed investment contracts and forward purchase agreement are rated as follows, by Standard & Poor's (S&P), Moody's and Fitch Ratings (Fitch), respectively, at March 31, 2008 (in millions):

	Amount	S&P	Moody's	Fitch
GIC Providers				
FSA	$ 100	AAA	Aaa	AAA
Royal Bank of Canada	100	AA-	Aaa	AA
Sun America	150	AA+	Aa2	AA+
	$ 350			
FPA Provider				
Merrill Lynch: FHLMC Discounted Notes	$ 100	AAA	Aaa	AAA

In February 2008 DWR exercised its right to terminate its $150 million guaranteed investment contract with XL Capital and invested the funds in SMIF.

3. Long-Term Debt

The following activity occurred in the long-term debt accounts during the nine months ended March 31, 2008 (in millions):

	Revenue Bonds	Unamortized Premium	Deferred Loss on Defeasance	Total Revenue Bonds
Balance, June 30, 2007	$ 10,054	$ 137	$ (196)	$ 9,995
Refunding				
Issuance of Debt	1,007	43		1,050
Defeasance of Debt	(1,050)			(1,050)
Amortization		(24)	11	(13)
Less current portion	(470)	(28)	15	(483)
Balance, March 31, 2008	$ 9,541	$ 128	$ (170)	$ 9,499

The tax exempt revenue bonds consist of the following at March 31, 2008 (in millions):

Series	Rates	Fiscal Year of Final maturity	Fiscal Year of First Call Date	Amount Outstanding
A	3.1-6.0%	2018	2012	$ 3,274
B	Variable	2020	Callable	1,000
C	Variable	2022	Callable	2,483
F	Variable	2022	Callable	759
G	Variable	2018	Callable	1,488
H	3.8-5.0%	2022	2018	1,007
				10,011
Plus unamortized bond premium				156
Less deferred loss on defeasance				(185)
Less current maturities				(483)
				$ 9,499

The interest rates for the variable debt for the nine months ended March 31, 2008, ranged from 0.49% to 10.94%. Variable rate markets were adversely affected by credit turmoil related to bond insurers during the period. DWR's outstanding variable rate bonds with associated bond insurance incurred interest costs reflecting the credit risk.

Future payment requirements on the revenue bonds are as follows at March 31, 2008 (in millions):

Fiscal Year	Principal	Interest [1]	Total
2008	$ 470	$ 87	$ 557
2009	493	325	819
2010	518	303	821
2011	545	280	825
2012	573	258	831
2013-2017	3,319	902	4,220
2018-2022	4,093	347	4,440
	$ 10,011	$ 2,502	$ 12,513

[1] Variable portion of interest cost calculated using the March 31, 2008 Securities Industry and Financial Markets Association Swap index (SIFMA).

Prior to March 2008 DWR had $500 million in auction rated debt and $1.325 billion in other variable rate debt that was insured by insurance companies that have recently been downgraded from their former AAA credit ratings. In March 2008 DWR began a process to refund this debt by the issuance of a combination of fixed rate debt and variable rate debt enhanced by direct pay letters of credit.

In March 2008, DWR issued Series H fixed rate revenue bonds with a par value of $1.007 billion. The Series H bonds were sold with a premium of $43 million. DWR incurred current period costs of $12 million for the issuance of the Series H bonds.

The proceeds of the Series H bonds, along with $21 million of funds released from the Bond Charge Payment Account and the Debt Service Reserve Account, were used to redeem $250 million from

Series C, $500 million from Series D auction rate bonds, and $300 million from Series G plus interest at various dates through April 30, 2008. For purposes of financial reporting, the refunded bonds are considered to be defeased as of March 31, 2008 and the related liabilities have been removed from the financial statements.

Subsequent to March 31, 2008, DWR issued three additional revenue bond series to redeem the remaining $775 million ($150 million from Series C and $625 million from Series G) in variable rate debt insured by bond insurance companies that recently lost their AAA credit ratings. All the refunded bonds were redeemed by May 8, 2008. Summary information is shown below (in millions).

Series	Par Amount	Interest Rate	Amount of Refunded Debt	Closing Date of Bond Issuance
I	$ 150	Variable	$ 150	April 2, 2008
J	330	Variable	330	April 17, 2008
K	280	4.0-5.0%	295	May 8, 2008
	$ 760		$ 775	

4. Interest Rate Swaps

The terms, fair values, and credit ratings of counterparties for the various swap agreements at March 31, 2008 are summarized in the following table (in millions):

Outstanding Notional Amount	Fixed Rate Paid by Fund	Variable Rate [1] Received by Fund	Fair Value	Swap Termination Date	Counterparty Credit Rating S&P	Moody's	Fitch
$ 94	2.914%	67% of LIBOR	$ (4)	May 1, 2011	AAA	Aaa	AAA
234	3.024%	67% of LIBOR	(11)	May 1, 2012	AAA	Aaa	AAA
190	3.405%	SIFMA	(7)	May 1, 2013	AA-	Aa2	AA-
95	3.405%	SIFMA	(4)	May 1, 2013	AA-	Aa3	AA-
28	3.405%	SIFMA	(1)	May 1, 2013	A+	A1	A+
194	3.204%	67% of LIBOR	(11)	May 1, 2014	AA	Aa1	AA
308	3.184%	66.5% of LIBOR	(13)	May 1, 2015	A+	Aa3	AA-
174	3.280%	67% of LIBOR	(11)	May 1, 2015	AAA	Aaa	AAA
202	3.342%	67% of LIBOR	(13)	May 1, 2016	AA+	Aa1	AA
485	3.228%	66.5% of LIBOR	(25)	May 1, 2016	AA+	Aa1	AA
202	3.389%	67% of LIBOR	(14)	May 1, 2017	AA-	Aa3	AA-
480	3.282%	66.5% of LIBOR	(24)	May 1, 2017	AA-	Aa3	AA-
514	3.331%	66.5% of LIBOR	(29)	May 1, 2018	AA	Aa1	AA-
306	3.256%	64% of LIBOR	(17)	May 1, 2020	AA	Aa1	AA-
453	3.325%	64% of LIBOR	(27)	May 1, 2022	AA-	Aaa	AA
$ 3,960			$ (211)				

[1] One month U.S. Dollar London Interbank Offered Rate or Securities Industry and Financial Markets Association Swap Index.

The notional amounts of the swaps match the principal amounts of the associated debt. The swap agreements contain scheduled reductions in notional amounts that follow scheduled amortization of the associated debt.

As of March 31, 2008, the variable rates on DWR's hedged bonds ranged from 0.49% to 10.94%, while 64%, 66.5% and 67% of LIBOR received on a portion of the swaps was equal to 2.00%, 2.07%, and 2.09% respectively and BMA received on a portion of the swaps was 2.21%.

Basis Risk: The Fund is exposed to basis risk on the swaps that have payments calculated on the basis of a percentage of LIBOR (a taxable rate index). The terms, fair values, and credit ratings of the counterparties for the basis swaps at March 31, 2008 are summarized in the following table (in millions):

Outstanding Notional Amount	Variable Rate [1] Paid by Fund	Variable Rate [2] Received by Fund	Fair Value	Swap Termination Date	Counterparty Credit Rating S&P	Moody's	Fitch
$ 234	67% of LIBOR	62.83% of CMS	6	May 1, 2012	AA+	Aa1	AA
194	67% of LIBOR	62.70% of CMS	6	May 1, 2014	AA	Aa1	AA-
174	67% of LIBOR	62.60% of CMS	5	May 1, 2015	AA-	Aa2	AA-
202	67% of LIBOR	62.80% of CMS	7	May 1, 2016	AA+	Aa1	AA
202	67% of LIBOR	62.66% of CMS	7	May 1, 2017	AA-	Aa2	AA-
$ 1,006			$ 31				

[1] One month U.S. Dollar London Interbank Offered Rate
[2] Five year Constant Maturity Swap

As of March 31, 2008, 67% of LIBOR paid on the basis swaps was equal to 3.50% while the variable rates received based on the 5 year CMS Index varied from 2.25 to 2.26%.

Fair Value: The reported fair values in the tables above were determined based on quoted market prices for similar financial instruments.

Credit Risk: As of March 31, 2008, the Fund was exposed to $5 million of credit risk because a single counterparty had a net positive value in regards to all swaps with that entity. That counterparty has a credit rating of AA-/Aa2/AA- and the swaps total 11% of outstanding notional amounts. All swap counterparties have investment grade credit ratings from the three major credit rating agencies shown in the tables.

Termination Risk: DWR's swap agreements do not contain any out-of-the-ordinary termination provisions that would expose it to significant termination risk.

Rollover Risk: Since the swap agreements have termination dates and notional amounts that are tied to equivalent maturity dates and principal amounts of amortizing debt, there is no rollover risk associated with the swap agreements, other than in the event of a termination.

Swap Payments and Associated Debt: As rates vary, variable rate bond interest payments and net swap interest payments will vary. As of March 31, 2008, debt service requirements of the variable rate debt and net swap payments, assuming current interest rates remain the same, for their term were as follows (in millions):

Fiscal Year	Variable Rate Bonds Principal	Variable Rate Bonds Interest	Interest Rate Swaps, Net	Total
2008	$ 21	$ 22	$ 11	$ 55
2009	127	87	45	258
2010	80	84	44	207
2011	241	82	42	365
2012	258	76	40	375
2013-2017	1,959	301	164	2,425
2018-2022	1,274	70	41	1,385
	$ 3,960	$ 722	$ 387	$ 5,070

5. Commitments and Contingencies

Litigation and Regulatory Proceedings

Certain pending legal and administrative proceedings involving DWR or affecting DWR's power supply program are summarized below.

California Refund Proceedings: During 2001 and 2002, DWR purchased power in bilateral transactions (both short term and long term), sold power to the California Independent System Operator (CAISO), paid for power purchased by the CAISO and purchased power from the CAISO for sale to customers of the IOUs. In July 2001, the Federal Energy Regulatory Commission (FERC) initiated an administrative proceeding to calculate refunds for inflated prices in the CAISO and California Power Exchange (PX) markets during 2000 and 2001. FERC ruled that DWR would not be entitled in that proceeding to approximately $3.5 billion in refunds associated with DWR's approximately $5 billion of short term purchases because DWR made those purchases bilaterally, not in the PX or CAISO markets. The Ninth Circuit Court of Appeals affirmed FERC, but left open the possibility of refunds on DWR's bilateral purchases in other FERC proceedings. In contrast, FERC ruled that DWR is entitled to refunds on purchases made by the CAISO where DWR actually paid the bill.

Of DWR's $5 billion in short term bilateral purchases, $2.9 billion was imbalance energy which DWR sold to the CAISO at DWR's cost in order to meet the CAISO's emergency needs during 2001. DWR is treated in the FERC refund proceeding as a seller of that energy to CAISO, and in May 2004, FERC issued an order requiring DWR to pay refunds on the sales to the CAISO. However, because DWR would likely be the primary recipient of any refunds on energy it sold to the CAISO, DWR's potential net liability associated with its sales to the CAISO would be substantially reduced. Settlements executed to date with various sellers have reduced that potential liability even further.

Under FERC's orders, therefore, DWR both owes refunds (on the energy it sold to the CAISO) and is entitled to refunds (on the energy that the CAISO purchased but DWR paid for); the effect of offsetting the two is likely to be that DWR would receive refunds.

As to refunds owed, FERC has ruled that to the extent DWR could demonstrate that payment of refunds would result in DWR's costs exceeding its revenues remaining after payment of refunds, DWR could request FERC to reduce the refunds. DWR made a cost recovery filing that DWR believes demonstrates that its costs related to sales to the CAISO exceeded its revenues, a demonstration that, if approved by FERC, would eliminate any refund amount DWR might otherwise be required to pay. In January 2006, FERC deferred action on DWR's cost filing on the basis that DWR, as described above, likely will be a net refund recipient, and net refund recipients, according to FERC, cannot make cost filings. Certain California parties have sought rehearing of that order.

In addition, in September 2005, the Ninth Circuit Court of Appeals ruled that FERC could not require governmental entities such as DWR to pay refunds.

Accordingly, DWR likely will be a net refund recipient in the FERC proceedings. Pending litigation could increase or decrease the level of the refunds DWR would be entitled to receive. DWR does not expect that FERC will order it to pay more in refunds than it receives on a market-wide basis.

Block Forward Contracts: In February 2001, the State commandeered block forward contracts between the PX and six suppliers. DWR took delivery of and paid a total of $350 million for energy under the contracts. Certain market participants claimed over $1 billion from the State in actions that were coordinated before the Sacramento County Superior Court. Subsequently, all but one market participant dismissed their complaints. In February 2008, the Superior Court granted the State's motion for summary judgment against the remaining market participant.

Commitments

DWR has power purchase contracts that have remaining lives of up to seven years. Payments under these contracts approximated $3.4 billion and $3.6 billion for the nine month periods ended March 31, 2008 and 2007 respectively.

In December 2007, a significant power purchase contract was amended and restructured. The effect of the restructured agreement is to decrease future fixed obligations by more than $1 billion through December 2009.

The remaining amounts of fixed obligations under all contracts as of March 31, 2008, are as follows (in millions):

Fiscal Year	Fixed Obligation
2008	$ 382
2009	1,720
2010	1,501
2011	1,070
2012	460
Thereafter	108
	$ 5,241

In addition to the fixed costs there are variable costs under several of the contracts. Management projects as of March 31, 2008 that the amount of future fixed and variable obligations associated with long-term power purchase contracts would approximate $12 billion. The difference between the fixed costs and the expected total costs of the contracts are primarily due to the variable factors associated with dispatchable contracts and the cost of natural gas.

Six of the power purchase contracts do not qualify as normal purchases and normal sales under the provisions of Governmental Accounting Standards Board Technical Bulletin 2003-1, *Disclosure Requirements for Derivatives Not Reported at Fair Value on the Statement of Net Assets*, primarily resulting from either pricing terms that contain variables which are not clearly and closely related to the base energy price or the seller is not a generator of electricity. As a result, certain information regarding these power purchase contracts is required to be disclosed. The fair value of these six contracts at March 31, 2008 approximated $20 million, using forward market prices discounted at prevailing LIBOR rates.

DWR also has entered into transactions to hedge the price of natural gas through bilateral arrangements. The fair value of the various transactions at March 31, 2008 approximated $142 million, using forward market prices. These transaction volumes vary in size from 2,500 to 25,000 mmBtu per day, and they expire at various times from May 2008 through December 2011.