OTAY WATER DISTRICT
FINANCE, ADMINISTRATION AND COMMUNICATIONS
COMMITTEE MEETING
and
SPECIAL MEETING OF THE BOARD OF DIRECTORS

2554 SWEETWATER SPRINGS BOULEVARD
SPRING VALLEY, CALIFORNIA
BOARDROOM

TUESDAY
October 19, 2010
11:30 A.M.

This is a District Committee meeting. This meeting is being posted as a special meeting in order to comply with the Brown Act (Government Code Section §54954.2) in the event that a quorum of the Board is present. Items will be deliberated, however, no formal board actions will be taken at this meeting. The committee makes recommendations to the full board for its consideration and formal action.

AGENDA

1. ROLL CALL

2. PUBLIC PARTICIPATION – OPPORTUNITY FOR MEMBERS OF THE PUBLIC TO SPEAK TO THE BOARD ON ANY SUBJECT MATTER WITHIN THE BOARD'S JURISDICTION BUT NOT AN ITEM ON TODAY'S AGENDA

DISCUSSION ITEMS

3. APPROVE THE DISTRICT'S AUDITED FINANCIAL STATEMENTS, INCLUDING THE INDEPENDENT AUDITORS' UNQUALIFIED OPINION, FOR FISCAL YEAR ENDED JUNE 30, 2010 (CUDLIP) [5 minutes]

4. ADOPT RESOLUTION NO. 4162 OF THE DISTRICT'S CODE OF ORDINANCES AMENDING POLICY NO. 25, RESERVE POLICY, WHICH INCLUDES THE UPDATED CAPACITY, ANNEXATION AND NEW WATER SUPPLY FEES (BELL) [5 minutes]

5. APPROVE THE ADJUSTMENT OF THE WHEELING RATE FOR THE DELIVERY OF TREATY WATER TO THE CITY OF TIJUANA TO $68.45 PER ACRE-FOOT FOR CALENDAR YEAR 2011 (CUDLIP) [5 minutes]

6. APPROVE AGREEMENTS WITH ADVANCED CALL PROCESSING CORPORATION IN AN AMOUNT NOT-TO-EXCEED $400,000 FOR TELECOMMUNICATIONS EQUIPMENT AND SERVICES AND FANDEL ENTERPRISES FOR AN AMOUNT NOT-TO-EXCEED $40,000 FOR TELECOMMUNICATION CONSULTING AND IMPLEMENTATION SERVICES (STEVENS) [5 minutes]

7. APPROVE AMENDMENTS TO SECTION 7.2.8, BOARD AUTHORIZED PURCHASES EXCEEDING THE GENERAL MANAGER'S AUTHORITY, OF THE DISTRICT'S PURCHASING MANUAL (DOBRAWA) [5 minutes]

8. ADJOURNMENT

BOARD MEMBERS ATTENDING:
Jaime Bonilla, Chair
Mark Robak

All items appearing on this agenda, whether or not expressly listed for action, may be deliberated and may be subject to action by the Board.

The Agenda, and any attachments containing written information, are available at the District's website at www.otaywater.gov. Written changes to any items to be considered at the open meeting, or to any attachments, will be posted on the District's website. Copies of the Agenda and all attachments are also available through the District Secretary by contacting her at (619) 670-2280.

If you have any disability which would require accommodation in order to enable you to participate in this meeting, please call the District Secretary at 670-2280 at least 24 hours prior to the meeting.

Certification of Posting

I certify that on October 15, 2010 I posted a copy of the foregoing agenda near the regular meeting place of the Board of Directors of Otay Water District, said time being at least 24 hours in advance of the meeting of the Board of Directors (Government Code Section §54954.2).

Executed at Spring Valley, California on October 15, 2010.

Susan Cruz, District Secretary

AGENDA ITEM 3

STAFF REPORT

TYPE MEETING:	Regular Board	MEETING DATE:	November 3, 2010
SUBMITTED BY:	James Cudlip, ~~Finance~~ Manager	W.O./G.F. NO:	DIV. NO. All
APPROVED BY: (Chief)	Joseph R. Beachem, Chief Financial Officer		
APPROVED BY: (Asst. GM):	German Alvarez, Assistant General Manager, Finance and Administration		
SUBJECT:	Approve the District's Audited Financial Statements for the Fiscal Year Ended June 30, 2010		

GENERAL MANAGER'S RECOMMENDATION:

That the Board approves the District's Audited Financial Statements (Attachment B), including the Independent Auditors' unqualified opinion, for the fiscal year ended June 30, 2010.

COMMITTEE ACTION:

See Attachment A.

PURPOSE:

To inform the Board of the significant financial events which occurred during the fiscal year ended June 30, 2010 as reflected in the audited financial statements.

ANALYSIS:

Diehl, Evans & Company, LLP, performed the audit and found that, in all material respects, the financial statements correctly represent the financial position of the District. They found no material errors or weaknesses; therefore, there are no findings to present in their "Management Letter." See Attachment C.

Total Assets:

Total Assets increased by $55.5 million or 10.08% during Fiscal Year 2010 due primarily to the issuance of $51.2 million in new water revenue bonds. At the same time there was an increase in capital assets of $17.0 million or 3.75%, net of related accumulated depreciation.

Total Liabilities & Net Assets:

Total liabilities increased by approximately $52.6 million or 58.12% from the previous fiscal year. This was also directly attributable to the issuance of the new bonds. Overall, long-term debt increased $48.6 million or 70.30%. Additionally, accounts payable increased $3.8 million or 32.52%. Fluctuations of this magnitude are expected given the nature of accounts payable, and result from the timing of large payments to vendors and other third parties.

The increase in total assets, along with the decrease in total liabilities, yielded an increase in net assets (equity) of approximately $2.9 million or 0.63%.

Capital Contributions:

Capital contributions totaled $9.1 million during Fiscal Year 2010, an increase of $2.1 million or 29.76% over Fiscal Year 2009 contributions. This increase is mainly due to the District receiving $2.4 million more than expected in federal grant monies as a result of last minute availability of funds from the federal budget.

Results of Operations:

Operating revenues increased $3.4 million or 5.87%, mainly as a result of the overall increase in water rates from the prior fiscal year.

While cost of water sales increased $2.1 million or 5.60% due to the increase in CWA water costs, cost savings achieved in other areas were sufficient to keep total operating expenses from rising significantly compared to the prior fiscal year.

Non-Operating Revenues & Expenses:

Non-operating revenues dropped $5.3 million or 37.70% due to a combination of factors. First, there was a decrease in investment income due to a continuing drop in rates on investment securities. Also, in FY-2009 the District received a large, one-time legal settlement as a member of a class action lawsuit against a major supply vendor. Finally, in the prior year the District brought in capacity fee revenue to offset the write-off of a capital asset project that was deemed no longer economically viable for continued operations.

Additional Audit Correspondence:

As a part of completing the audit engagement, the audit firm also provides the following letters summarizing their observations and conclusions concerning the District's overall financial processes:

- Management Letter: The auditors did not identify any deficiencies in internal control that they considered to be material weaknesses. See Attachment C.

- Capitalized Interest Letter: The auditors reviewed the District's new 2010 Water Revenue Bond documentation and determined that a different, more recently enacted accounting principle should be applied to account for the interest capitalization of this debt issue. This resulted in an audit reclassification from expense to capital projects of $436,369. See Attachment D.

- Audit Committee Letter: There were no noted transactions entered into by the District during the year that were both significant and unusual, or transactions for which there was a lack of authoritative guidance or consensus. There were no disagreements with management concerning financial accounting, reporting, or auditing matters, and there were no significant difficulties in dealing with management in performing the audit. See Attachment E.

- Report on Applying Agreed-Upon Procedures: A review of the District's investment portfolio at year end, and a sample of specific investment transactions completed throughout the fiscal year, disclosed no exceptions to compliance with the District's Investment Policy. See Attachment F.

FISCAL IMPACT:

None.

STRATEGIC OUTLOOK:

The District ensures its continued financial health through long-term financial planning, formalized financial policies, enhanced budget controls, fair pricing, debt planning, and improved financial reporting.

LEGAL IMPACT:

None.

General Manager

Attachments:

A) Committee Action Form
B) Audited Annual Financial Statements
C) Management Letter
D) Capitalized Interest Letter
E) Audit Committee Letter
F) Report on Applying Agreed-Upon Procedures

ATTACHMENT A

SUBJECT/PROJECT:	Approve the District's Audited Financial Statements for the Fiscal Year Ended June 30, 2010

COMMITTEE ACTION:

The Finance, Administration, and Communications Committee recommend that the Board approves the District's audited financial statements, including the Independent Auditor's unqualified opinion, for the fiscal year ended June 30, 2010.

NOTE:

The "Committee Action" is written in anticipation of the Committee moving the item forward for board approval. This report will be sent to the Board as a committee approved item, or modified to reflect any discussion or changes as directed from the committee prior to presentation to the full board.

Attachment B

OTAY WATER DISTRICT

FINANCIAL STATEMENTS

WITH REPORT ON AUDIT BY INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

JUNE 30, 2010 AND 2009

TABLE OF CONTENTS

JUNE 30, 2010 and 2009

DIEHL, EVANS & COMPANY, LLP
CERTIFIED PUBLIC ACCOUNTANTS & CONSULTANTS

A PARTNERSHIP INCLUDING ACCOUNTANCY CORPORATIONS

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* A PROFESSIONAL CORPORATION

October 12, 2010

INDEPENDENT AUDITORS' REPORT

Board of Directors
Otay Water District
Spring Valley, California

We have audited the accompanying basic financial statements of Otay Water District as of and for the years ended June 30, 2010 and 2009, as listed in the table of contents. These basic financial statements are the responsibility of the Otay Water District's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the Otay Water District as of June 30, 2010 and 2009, and the changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, PERS Defined Benefit Pension Plan – schedule of funding progress, and other post-employment benefit plan – schedule of funding progress, as identified in the accompanying table of contents 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.

Diehl, Evans and Company, LLP

OTHER OFFICES AT:

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Management's Discussion and Analysis

As management of the Otay Water District (the "District"), we offer readers of the District's financial statements this narrative overview and analysis of the District's financial performance during the fiscal year ending June 30, 2010. Please read it in conjunction with the District's financial statements that follow Management's Discussion and Analysis. All amounts, unless otherwise indicated, are expressed in millions of dollars.

Financial Highlights

- The assets of the District exceeded its liabilities at the close of the most recent fiscal year by $463.3 million *(net assets).* Of this amount, $80.2 million *(unrestricted net assets)* may be used to meet the District's ongoing obligations to citizens and creditors.
- The District's total net assets increased by $2.9 million. This is primarily attributable to the increase in capital contributions of $9.1 million during the fiscal year.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the District's basic financial statements, which are comprised of the following: 1) Statement of Net Assets, 2) Statement of Revenues, Expenses and Changes in Net Assets, 3) Statement of Cash Flows, and 4) Notes to the financial Statements. This report also contains other supplementary information in addition to the basic financial statements.

The *Statement of Net Assets* presents information on all of the District's assets and liabilities, with the difference between the two reported as *net assets*. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the District is improving or weakening.

The *Statement of Revenues, Expenses and Changes in Net Assets* presents information showing how the District's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, *regardless of the timing of related cash flows*. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave).

The *Statement of Cash Flows* presents information on cash receipts and payments for the fiscal year.

The *Notes to the Financial Statements* provide additional information that is essential to a full understanding of the data supplied in each of the specific financial statements listed above.

In addition to the basic financial statements and accompanying notes, this report also presents certain *required supplementary information* concerning the District's progress in funding its obligation to provide pension benefits to its employees.

Financial Analysis

As noted earlier, net assets may serve over time as a useful indicator of an entity's financial position. In the case of the District, assets exceeded liabilities by $463.3 million at the close of the most recent fiscal year.

By far the largest portion of the District's net assets, $377.9 million (82%), reflects its investment in capital assets, less any remaining outstanding debt used to acquire those assets. The District uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the District's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

Statements of Net Assets
(In Millions of Dollars)

	2010	2009	2008
Assets			
Current and Other Assets	$ 135.4	$ 96.8	$ 106.2
Capital Assets	471.1	454.1	446.7
Total Assets	606.5	550.9	552.9
Liabilities			
Long-term Debt Outstanding	117.7	69.1	71.6
Other Liabilities	25.5	21.5	24.5
Total Liabilities	143.2	90.6	96.1
Net Assets			
Invested in Capital Assets Net of Related Debt	377.9	382.4	372.7
Restricted for Debt Service	5.2	1.8	3.8
Unrestricted	80.2	76.1	80.3
Total Net Assets	$ 463.3	$ 460.3	$ 456.8

At the end of FY-2010 the District is able to report positive balances in all categories of net assets. This situation also held true for the prior two fiscal years. In FY-2010 total Net Assets increased approximately $2.9 million, to $463.3 million, as compared to FY-2009 when Net Assets increased by over $3.5 million. While the District's operations and population continue to grow, albeit at slower rates than in prior years, the pattern of reduced growth of the District's Net Assets is indicative of the reduction in new development projects within the District. This reduction is a result of the ongoing national housing slump and financial crisis.

In FY-2009 the decrease in Current and Other Assets of $9.4 million corresponds with the increase in Capital Assets of $7.4 million (net of accumulated depreciation), due primarily to the District's Capital Improvement Plan (CIP), which was financed in part by the funds remaining from the FY-2007 issuance of $42 million in Certificates of Participation (COPS-2007).

In FY-2010 the District issued $51.2 million of new Water Revenue Bonds, contributing to the increase in Current and Other Assets of $38.5 million, and the increase in Long-term Debt Outstanding of $48.6 million. (See Note 5 in the Notes to Financial Statements). The use of the 2010 Water Revenue Bonds is also reflected in the increase in Capital Assets of $17.0 million, as the District continued its CIP program. (See Note 3 in the Notes to Financial Statements).

Statements of Revenues, Expenses, and Changes in Net Assets
(In Millions of Dollars)

	2010	2009	2008
Water Sales	$ 56.3	$ 52.4	$ 50.8
Wastewater Revenue	2.3	2.2	2.4
Connection and Other Fees	1.9	2.5	2.5
Non-operating Revenues	8.7	14.0	13.6
Total Revenues	69.2	71.1	69.3
Depreciation Expense	13.3	12.5	13.0
Other Operating Expense	59.3	59.0	58.5
Non-operating Expense	2.8	3.1	2.9
Total Expenses	75.4	74.6	74.4
Loss Before Capital Contributions	(6.2)	(3.5)	(5.1)
Capital Contributions	9.1	7.0	14.9
Change in Net Assets	2.9	3.5	9.8
Beginning Net Assets	460.3	456.8	447.0
Ending Net Assets	$ 463.2	$ 460.3	$ 456.8

Water Sales increased by $1.6 million in FY-2009 and $3.9 million in FY-2010, mainly due to reduced rainfall during FY-2009 as well as rate increases in both years. The slowdown in growth throughout the District was also reflected in the decrease in Connection and Other Fees of $0.6 million in FY-2010.

Non-operating Revenues increased by $0.4 million in FY-2009 due primarily to increased property tax revenues. However in FY-2010, Non-operating Revenues decreased by $5.3 million due to a combination of factors. First, there was a decrease in investment income due to a continuing drop in rates on investment securities. Also, in FY-2009 the District received a large, one-time legal settlement as a member of a class action lawsuit against a major supply vendor. Finally, in the prior year the District brought in capacity fee revenue to offset the write-off of a capital asset project that was deemed no longer economically viable for continued operations.

Capital Contributions were $14.9 million in FY-2008 due to the completion of several developer construction projects. However, because of the nationwide housing mortgage crisis throughout the last several years, developers have either slowed-down or totally stopped work on many projects until economic conditions improve and the demand for growth returns. This has resulted in a decrease in Capital Contributions of $7.9 million in FY-2009. By FY-2010 this slowdown appears to have stabilized, while the District received $2.4 million more than expected in federal grant monies due to last minute availability of funds from the federal budget.

Capital Assets and Debt Administration

Capital Assets. The District's capital assets as of June 30, 2010, totaled $471.1 million (net of accumulated depreciation). Included in this amount is land. The total increase in the District's capital assets was 1.7% for FY-2009 and 3.7% in FY-2010.

Capital Assets
(In Millions of Dollars)

	2010	2009	2008
Land	$ 13.6	$ 13.4	$ 13.0
Construction in Progress	37.1	18.3	42.3
Water System	409.5	403.1	365.6
Recycled Water System	97.7	96.8	93.0
Sewer System	37.4	37.2	36.7
Field Equipment	18.5	18.2	17.6
Buildings	9.5	9.5	9.5
Transportation Equipment	3.3	3.3	3.1
Communication Equipment	1.3	0.8	0.7
Office Equipment	18.4	17.4	16.8
	646.3	618.0	598.3
Less Accumulated Depreciation	(175.2)	(163.9)	(151.6)
Net Capital Assets	$ 471.1	$ 454.1	$ 446.7

As indicated by figures in the table above, the majority of capital assets added during both fiscal years were related to the potable and recycled water systems. In addition, the majority of the cost of construction in progress is also related to these water systems.

Additional information on the District's capital assets can be found in Note 3 of the Notes to Financial Statements.

Long-term Debt. At June 30, 2010, the District had $117.7 million in outstanding debt which consisted of the following:

General Obligation Bonds	$ 6.8
Certificates of Participation	59.7
Revenue Bonds	51.2
Total Long-term Debt	$ 117.7

Additional information on the District's long-term debt can be found in Note 5 of the Notes to Financial Statements.

Fiscal Year 2010-2011 Budget

Economic Factors

Growth in the San Diego area has slowed over the last 3 years, and demand for housing is reflected in a similarly reduced pace. Water sales volumes have gradually decreased as a result of a combination of the slowing economy and expanded efforts to promote water conservation. After years of record low precipitation that dramatically curtailed snow runoff from the Sierra Nevada Mountains, California's governor declared an official statewide drought in June 2008. Following the governor's action, all local jurisdictions were urged to implement water conservation ordinances and to "significantly increase efforts" to conserve water. In addition to the drought, federal court orders have curtailed water deliveries from Northern California due to environmental factors in the Sacramento-San Joaquin Bay Delta. A greater focus on environmental conditions in the Bay Delta brings added challenges to the delivery of water through the State Water Project. In order to maintain the ongoing supply of water to Southern California the various and competing interests need to arrive at genuine solutions. The combination of these factors will add to the cost of providing water. At the same time, ongoing water supply rate increases from the Metropolitan Water District (MWD) and the San Diego County Water Authority (CWA) have required the District to implement rate increases to pass-through these costs, as well as increases in energy costs and operating costs.

The District currently provides water service to about 70% of its total projected population, serving approximately 206,000 people. Long-term, this percentage should continue to increase as the District's service area continues to develop and grow. Ultimately, the District is projected to serve approximately 295,000 people, with an average daily demand of 55 million gallons per day (MGD). Currently, the District services the needs of this growing population by purchasing water from CWA, who in turn purchases its water from MWD and the Imperial Irrigation District (IID). Otay takes delivery of the water through several connections of large diameter pipelines owned and operated by CWA. The District currently receives treated water from CWA, and the Helix Water District (HWD) by contract with CWA. In addition, the District has an emergency agreement with the City of San Diego in the case of a shutdown of the main treated water source. Through innovative agreements like this, benefits can be achieved by both parties by using excess capacity of another agency, and diversifying local supply, thereby increasing reliability.

Financial

The District is projected to deliver approximately 29,900 acre-feet of potable water to 48,060 potable customer accounts during Fiscal Year 2010-2011. Management feels that these projections are very realistic after accounting for low growth, supply changes, and a focus on conservation. Current economic conditions throughout America have created an unprecedented uncertainty for business and economic projections in the current fiscal year. The nationwide housing mortgage crisis has resulted in hundreds of foreclosures throughout the District. Additionally, the crisis in the banking and financial industry has begun to have a ripple effect of employee layoffs across a wide swath of the business community. One of the subsequent results of these two broad events is the relocation of many homeowners and renters into new housing arrangements throughout San Diego County. Even with the housing patterns change throughout the District, people's need for water remains an underlying constant. Staff continues working diligently on developing new water supplies as it addresses the financial impacts of conservation, preparing for the possibility of a continued water shortage, and prolonged sales reductions.

Management is unaware of any other conditions that could have a significant impact on the District's current financial position, net assets or operating results.

Contacting the District's Financial Management

This financial report is designed to provide a general overview of the Otay Water District's finances for the Board of Directors, taxpayers, creditors, and other interested parties. Questions concerning any of the information provided in the report or requests for additional information should be addressed to the District's Finance Department, 2554 Sweetwater Springs Blvd., Spring Valley, CA 91978-2004.

STATEMENTS OF NET ASSETS
JUNE 30, 2010 AND 2009

	2010	2009
ASSETS		
Current Assets:		
Cash and cash equivalents (Notes 1 and 2)	$ 40,180,519	$ 50,823,237
Restricted cash and cash equivalents (Notes 1 and 2)	21,131,924	1,760,631
Investments (Note 2)	43,085,300	26,169,080
Restricted investments (Notes 1 and 2)	11,150,549	-
Accounts receivable, net	8,959,367	8,029,609
Accrued interest receivable	239,355	319,186
Taxes and availability charges receivable, net	366,535	413,000
Restricted taxes and availability charges receivable, net	186,813	190,151
Inventories	954,007	816,865
Prepaid expenses and other current assets	626,421	976,045
Total Current Assets	126,880,790	89,497,804
Noncurrent Assets:		
Net OPEB asset (Note 8)	6,783,385	6,204,876
Deferred bond issuance costs (Note 4)	1,703,282	1,142,762
Capital Assets (Note 3):		
Land	13,620,963	13,402,840
Construction in progress	37,081,849	18,280,278
Capital assets, net of depreciation	420,363,833	422,369,157
Total capital assets, net of depreciaton	471,066,645	454,052,275
Total Noncurrent Assets	479,553,312	461,399,913
Total Assets	606,434,102	550,897,717

(Continued)

Statements Of Net Assets (Continued)
June 30, 2010 and 2009

	2010	2009
LIABILITIES		
Current Liabilities:		
Current maturities of long-term debt (Note 5)	2,668,734	2,521,772
Accounts payable	15,327,365	11,565,953
Accrued payroll liabilities	2,743,408	2,548,731
Other accrued liabilities	638,015	444,875
Customer deposits	2,146,360	2,806,990
Accrued interest	1,154,286	706,934
Liabilities Payable From Restricted Assets:		
Restricted accrued interest	100,326	153,270
Total Current Liabilities	24,778,494	20,748,525
Noncurrent Liabilities:		
Long-term debt (Note 5):		
General obligation bonds	6,763,127	7,291,575
Certificates of participation	59,694,612	61,468,693
Revenue bonds	51,255,224	-
Notes payable	6,010	359,744
Other noncurrent liabilities	684,309	684,309
Total Noncurrent Liabilities	118,403,282	69,804,321
Total Liabilities	143,181,776	90,552,846
NET ASSETS		
Invested in capital assets, net of related debt	377,855,787	382,410,491
Restricted for debt service	5,192,111	1,797,512
Unrestricted	80,204,428	76,136,868
Total Net Assets	$ 463,252,326	$ 460,344,871

See accompanying independent auditors' report and notes to financial statements.

Statements Of Revenues, Expenses and Changes in Net Assets

For The Years Ended June 30, 2010 and 2009

	2010	2009
OPERATING REVENUES		
Water sales	$ 56,249,816	$ 52,428,648
Wastewater revenue	2,299,585	2,182,429
Connection and other fees	1,907,797	2,492,234
Total Operating Revenues	60,457,198	57,103,311
OPERATING EXPENSES		
Cost of water sales	39,338,495	37,252,482
Wastewater	2,169,988	1,890,804
Administrative and general	17,750,713	19,888,161
Depreciation	13,297,497	12,475,714
Total Operating Expenses	72,556,693	71,507,161
Operating Income (Loss)	(12,099,495)	(14,403,850)
NONOPERATING REVENUES (EXPENSES)		
Investment income	1,323,844	2,252,335
Taxes and assessments	3,973,328	4,586,823
Availability charges	670,784	625,065
Gain (loss) on sale of capital assets	(143,086)	5,206
Miscellaneous revenues	2,921,016	6,569,644
Donations	(100,240)	(95,270)
Interest expense	(2,404,530)	(1,340,110)
Miscellaneous expenses	(303,541)	(1,671,597)
Total Nonoperating Revenues (Expenses)	5,937,575	10,932,096
Income (Loss) Before Capital Contributions	(6,161,920)	(3,471,754)
Capital Contributions	9,069,375	6,989,208
Changes in Net Assets	2,907,455	3,517,454
Total Net Assets, Beginning	460,344,871	456,827,417
Total Net Assets, Ending	$ 463,252,326	$ 460,344,871

See accompanying independent auditors' report and notes to financial statements.

Statements Of Cash Flows

For The Years Ended June 30, 2010 and 2009

	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from customers	$ 56,959,013	$ 54,358,847
Receipts from connections and other fees	1,907,797	2,492,234
Other receipts	1,837,028	5,538,973
Payments to suppliers	(36,816,755)	(43,072,805)
Payments to employees	(18,659,239)	(18,947,144)
Other payments	(261,742)	(1,640,481)
Net Cash Provided (Used) by Operating Activities	4,966,102	(1,270,376)
CASH FLOWS FROM NONCAPITAL AND RELATED FINANCING ACTIVITIES		
Receipts from taxes and assessments	4,023,131	4,520,867
Receipts from property rents and leases	1,083,988	1,070,881
Net Cash Provided (Used) by Noncapital and Related Financing Activities	5,107,119	5,591,748
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from capital contributions	7,946,690	4,014,110
Proceeds from sale of capital assets	94,118	5,206
Proceeds from debt related taxes and assessments	670,784	625,065
Net proceeds from issuance of long-term debt	57,826,816	-
Retirements of long-term debt	(7,231,011)	-
Principal payments on long-term debt	(2,521,772)	(2,445,214)
Interest payments and fees	(2,477,159)	(1,366,547)
Acquisition and construction of capital assets	(28,990,017)	(16,838,494)
Net Cash Provided (Used) by Capital and Related Financing Activities	25,318,450	(16,005,874)
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest received on investments	1,336,944	2,494,196
Proceeds from sale and maturities of investments	53,997,000	70,703,937
Purchase of investments	(81,997,040)	(36,035,657)
Net Cash Provided (Used) by Investing Activities	(26,663,096)	37,162,476
Net Increase (Decrease) in Cash and cash equivalents	8,728,575	25,477,974
Cash and cash equivalents, Beginning	52,583,868	27,105,894
Cash and cash equivalents, Ending	$ 61,312,443	$ 52,583,868

(Continued)

See accompanying independent auditors' report and notes to financial statements.

STATEMENTS OF CASH FLOWS (CONTINUED)

FOR THE YEARS ENDED JUNE 30, 2010 AND 2009

	2010	2009
Reconciliation of operating income (loss) to net cash flows provided (used) by operating activities:		
Operating income (loss)	$ (12,099,495)	$ (14,403,850)
Adjustments to reconcile operating income to net cash provided (used) by operating activities:		
Depreciation	13,297,497	12,475,714
Miscellaneous revenues	1,837,028	5,538,973
Miscellaneous expenses	(261 742)	(1,640,481)
(Increase) decrease in accounts receivable	(929,758)	(339,889)
(Increase) decrease in inventory	(137,142)	(105,625)
(Increase) decrease in net OPEB asset	(578,509)	(555,868)
(Increase) decrease in prepaid expenses and other current assets	349,624	931,983
Increase (decrease) in accounts payable	3,761,412	(2,139,613)
Increase (decrease) in accrued payroll and related expenses	194,677	57,549
Increase (decrease) in other accrued liabilities	193,140	(1,170,528)
Increase (decrease) in customer deposits	(660,630)	87,659
Increase (decrease) in prepaid capacity fees	-	(6,400)
Net Cash Provided (Used) By Operating Activities	$ 4,966,102	$ (1,270,376)
Schedule of Cash and Cash Equivalents:		
Current assets:		
Cash and cash equivalents	$ 40,180,519	$ 50,823,237
Restricted cash and cash equivalents	21,131,924	1,760,631
Total Cash and Cash Equivalents	$ 61,312,443	$ 52,583,868
Supplemental Disclosures:		
Non-cash Investing and Financing Activities Consisted of the Following:		
Contributed Capital for Water and Sewer System	$ 1,122,685	$ 2,975,098
Change in Fair Value of Investments and Recognized Gains/Losses	230,747	21,613
Amortization Related to Long-Term Debt	142,039	126,387

See accompanying independent auditors' report and notes to financial statements.

1) REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A) Reporting Entity

Otay Water District (the "District") is a public entity established in 1956 pursuant to the Municipal Water District Law of 1911 (Section 711 et. Seq. of the California Water Code) for the purpose of providing water and sewer services to the properties in the District. The District is governed by a Board of Directors consisting of five directors elected by geographical divisions based on District population for a four-year alternating term.

B) Measurement Focus, Basis of Accounting and Financial Statement Presentation

The basic financial statements of the Otay Water District have been prepared in conformity with accounting principles generally accepted in the United States of America. The Governmental Accounting Standards Board (GASB) is the accepted standard setting body for governmental accounting financial reporting purposes.

The District reports its activities as an enterprise fund, which is used to account for operations that are financed and operated in a manner similar to a private business enterprise, where the intent of the District is that the costs (including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges. Revenues and expenses are recognized on the accrual basis. Revenues are recognized in the accounting period in which they are earned and expenses are recognized in the period incurred, regardless of when the related cash flow takes place.

Net assets of the District are classified into three components: (1) invested in capital assets, net of related debt, (2) restricted net assets, and (3) unrestricted net assets. These classifications are defined as follows:

<u>Invested in Capital Assets, Net of Related Debt</u>

This component of net assets consists of capital assets, net of accumulated depreciation and reduced by the outstanding balances of notes or borrowing that are attributable to the acquisition of the asset, construction, or improvement of those assets. If there are significant unspent related debt proceeds at year-end, the portion of the debt attributable to the unspent proceeds are not included in the calculation of invested in capital assets, net of related debt.

<u>Restricted Net Assets</u>

This component of net assets consists of constraints placed on net asset use through external constraints imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.

<u>Unrestricted Net Assets</u>

This component of net asset consists of net assets that do not meet the definition of "invested in capital assets, net of related debt" or "restricted net assets"

The District distinguishes operating revenues and expenses from those revenues and expenses that are nonoperating. Operating revenues are those revenues that are generated by water sales and wastewater services while operating expenses pertain directly to the furnishing of those services. Nonoperating revenues and expenses are those revenues and expenses generated that are not directly associated with the normal business of supplying water and wastewater treatment services.

The District recognizes revenues from water sales, wastewater revenues, and meter fees as they are earned. Taxes and assessments are recognized as revenues based upon amounts reported to the District by the County of San Diego, net of allowance for delinquencies of $61,483 and $67,017 at June 30, 2010 and 2009, respectively.

1) REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

B) Measurement Focus, Basis of Accounting and Financial Statement Presentation - Continued

Additionally, capacity fee contributions received which are related to specific operating expenses are offset against those expenses and included in Cost of Water Sales in the Statement of Revenues and Expenses and Changes in Net Assets.

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

The District has elected under GASB Statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Activities That Use Proprietary Fund Accounting, to apply all GASB pronouncements as well as any applicable pronouncements of the Financial Accounting Standards Board (FASB), the Accounting Principles Board (APB), or any Accounting Research Bulletins (ARB) issued on or before November 30, 1989, unless they contradict or conflict with GASB pronouncements.

C) Statement of Cash Flows

For purposes of the Statement of Cash Flows, the District considers all highly liquid investments (including restricted assets) with a maturity period, at purchase, of three months or less to be cash equivalents.

D) Investments

The District's investments are stated at fair value, except for short-term investments, which are reported at cost, which approximates fair value. Investments in governmental investment pools are reported on the fair value per share of the pool's underlying portfolio.

E) Inventory and Prepaids

Inventory consists primarily of materials used in the construction and maintenance of the water and sewer system and is valued at weighted average cost. Both inventory and prepaids use the consumption method whereby they are reported as an asset and expensed as they are consumed.

F) Capital Assets

Capital assets are recorded at cost, where historical records are available, and at an estimated historical cost where no historical records exist. Infrastructure assets in excess of $20,000 and other capital assets in excess of $10,000 are capitalized if they have an expected useful life of two years or more. The District will also capitalize individual purchases under the capitalization threshold if they are part of a new capital program. The cost of purchased and self-constructed additions to utility plant and major replacements of property are capitalized. Costs include materials, direct labor, transportation, and such indirect items as engineering, supervision, employee fringe benefits, and interest incurred during the construction period. Repairs, maintenance, and minor replacements of property are charged to expense. Donated assets are capitalized at their approximate fair market value on the date contributed.

The District capitalizes interest on construction projects up to the point in time that the project is substantially completed. Capitalized interest is included in the cost of water system assets and is depreciated on the straight-line basis over the estimated useful lives of such assets.

1) REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

F) Capital Assets - Continued

Depreciation is calculated using the straight-line method over the following estimated useful lives:

Water System	15-70 Years
Field Equipment	2-50 Years
Buildings	30-50 Years
Communication Equipment	2-10 Years
Transportation Equipment	2-4 Years
Office Equipment	2-10 Years
Recycled Water System	50-75 Years
Sewer System	25-50 Years

G) Compensated Absences

In accordance with GASB Statement No. 16, a liability is recorded for unused vacation and sick leave balances since the employees' entitlement to these balances are attributable to services already rendered and it is probable that virtually all of these balances will be liquidated by either paid time-off or payment upon termination or retirement.

H) Restricted Assets and Liabilities

Certain current liabilities have been classified as current liabilities payable from restricted assets as they will be funded from restricted assets.

I) Allowance for Doubtful Accounts

The District charges doubtful accounts arising from water sales receivable to bad debt expense when it is probable that the accounts will be uncollectible. Uncollectible accounts are determined by the allowance method based upon prior experience and management's assessment of the collectability of existing specific accounts. The allowance for doubtful accounts were $12,937 and $17,531 for 2010 and 2009 respectively.

J) Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America 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 revenues and expenses during the reporting period. Actual results could differ from those estimates.

K) Property Taxes

Tax levies are limited to 1% of full market value (at time of purchase) which results in a tax rate of $1.00 per $100 assessed valuation, under the provisions of Proposition 13. Tax rates for voter-approved indebtedness are excluded from this limitation.

The County of San Diego (the "County") bills and collects property taxes on behalf of the District. The County's tax calendar year is July 1 to June 30. Property taxes attach as a lien on property on January 1. Taxes are levied on July 1 and are payable in two equal installments on November 1 and February 1, and become delinquent after December 10 and April 10, respectively.

L) Reclassifications

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

2) CASH AND INVESTMENTS

The primary goals of the District's Investment Policy are to assure compliance with all Federal, State, and Local laws governing the investment of funds under the control of the organization, protect the principal of investments entrusted, and generate income under the parameters of such policies.

Cash and Investments are classified in the accompanying financial statements as follows:

Statement of Net Assets:		
Current Assets	2010	2009
Cash and Cash Equivalents	$ 40,180,519	$ 50,823,237
Restricted Cash and Cash Equivalents	21,131,924	1,760,631
Investments	43,085,300	26,169,080
Restricted Investments	11,150,549	-
Total Cash and Investments	$ 115,548,292	$ 78,752,948

Cash and Investments consist of the following:

	2010	2009
Cash on Hand	$ 2,800	$ 2,800
Deposits with Financial Institutions	4,158,859	5,701,125
Investments	111,386,633	73,049,023
Total Cash and Investments	$ 115,548,292	$ 78,752,948

Investments Authorized by the California Government Code and the District's Investment Policy

The table below identifies the investment types that are authorized for the District by the California Government Code (or the District's Investment Policy, where more restrictive). The table also identifies certain provisions of the California Government Code (or the District's Investment Policy, where more restrictive) that address interest rate risk, credit risk, and concentration of credit risk. This table does not address investments of debt proceeds held by bond trustee that are governed by the provisions of debt agreements of the District, rather than the general provisions of the California Government Code or the District's Investment Policy.

Authorized Investment Type	Maximum Maturity	Maximum Percentage Of Portfolio[(1)]	Maximum Investment In One Issuer
U.S. Treasury Obligations	5 years	None	None
U.S. Government Sponsored Entities	5 years	None	None
Certificates of Deposit	5 years	15%	None
Corporate Medium-Term Notes	5 years	15%	None
Commercial Paper	270 days	15%	10%
Money Market Mutual Funds	N/A	15%	None
County Pooled Investment Funds	N/A	None	None
Local Agency Investment Fund (LAIF)	N/A	None	None

[(1)] Excluding amounts held by bond trustee that are not subject to California Government Code restrictions.

2) CASH AND INVESTMENTS - Continued

Investments Authorized by Debt Agreements

Investments of debt proceeds held by the bond trustee are governed by provisions of the debt agreements, rather than the general provisions of the California Government Code or the District's Investment Policy.

Disclosures Relating to Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the District manages its exposure to interest rate risk is by purchasing a combination of shorter term and longer term investments and by timing cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturity evenly over time as necessary to provide the cash flow and liquidity needed for operations.

Information about the sensitivity of the fair values of the District's investments to market interest rate fluctuations are provided by the following tables that show the distribution of the District's investments by maturity as of June 30, 2010 and 2009.

June 30, 2010

Investment Type		Remaining Maturity (in Months) 12 Months Or Less	13 to 24 Months	25 to 60 Months	More Than 60 Months
U.S. Government Sponsored Entities	$ 53,911,225	$ -	$21,801,325	$32,109,900	$ -
Local Agency Investment Fund (LAIF)	34,561,668	34,561,668	-	-	-
Corporate Medium-Term Notes	4,062,740	4,062,740	-	-	-
San Diego County Pool	18,851,000	18,851,000	-	-	-
Total	$111,386,633	$57,475,408	$21,801,325	$32,109,900	$ -

June 30, 2009

Investment Type		Remaining Maturity (in Months) 12 Months Or Less	13 to 24 Months	25 to 60 Months	More Than 60 Months
U.S. Government Sponsored Entities	$ 22,048,400	$ -	$22,048,400	$ -	$ -
Local Agency Investment Fund (LAIF)	7,489,943	7,489,943	-	-	-
Corporate Medium-Term Notes	4,120,680	-	4,120,680	-	
San Diego County Pool	39,390,000	39,390,000	-	-	-
Total	$ 73,049,023	$46,879,943	$26,169,080	$ -	$ -

2) CASH AND INVESTMENTS - Continued

Disclosures Relating to Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. Presented below is the minimum rating required by (where applicable) the California Government Code or the District's Investment Policy, or debt agreements, and the actual rating as of June 30, 2010 and 2009 for each investment type.

June 30, 2010

Investment Type		Minimum Legal Rating	Rating as of Year End AAA	AA	Not Rated
U.S. Government Sponsored Entities	$ 53,911,225	N/A	$53,911,225	$ -	$ -
Local Agency Investment Fund (LAIF)	34,561,668	N/A	-	-	34,561,668
Corporate Medium-Term Notes	4,062,740	A		4,062,740	-
San Diego County Pool	18,851,000	N/A	-	-	18,851,000
Total	$111,386,633		$53,911,225	$ 4,062,740	$53,412,668

June 30, 2009

Investment Type		Minimum Legal Rating	Rating as of Year End AAA	AA	Not Rated
U.S. Government Sponsored Entities	$ 22,048,400	N/A	$22,048,400	$ -	$ -
Local Agency Investment Fund (LAIF)	7,489,943	N/A	-	-	7,489,943
Corporate Medium-Term Notes	4,120,680	A	2,061,960	2,058,720	-
San Diego County Pool	39,390,000	N/A	-	-	39,390,000
Total	$ 73,049,023		$24,110,360	$ 2,058,720	$46,879,943

2) CASH AND INVESTMENTS - Continued

Concentration of Credit Risk

The investment policy of the District contains various limitations on the amounts that can be invested in any one type or group of investments and in any issuer, beyond that stipulated by the California Government Code, Sections 53600 through 53692. Investments in any one issuer (other than U.S. Treasury securities, mutual funds, and external investment pools) that represent 5% or more of total District investments as of June 30, 2010 and 2009 are as follows:

June 30, 2010

Issuer	Investment Type	Reported Amount	
Federal Home Loan Bank	U.S. Government Sponsored Entities	$	20,044,400
Federal Home Loan Mortgage Corp	U.S. Government Sponsored Entities	$	11,791,825
Federal National Mortgage Association	U.S. Government Sponsored Entities	$	22,075,000

June 30, 2009

Issuer	Investment Type	Reported Amount	
Federal Home Loan Bank	U.S. Government Sponsored Entities	$	5,996,260
Federal Home Loan Mortgage Corp	U.S. Government Sponsored Entities	$	4,022,100
Federal National Mortgage Association	U.S. Government Sponsored Entities	$	10,033,780

Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty (e.g., broker-dealer) to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code and the Entity's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments, other than the following provision for deposits: The California Government Code requires that a financial institution secure deposits made by state or local government units by pledging securities in an undivided collateral pool held by a depository regulated under state law (unless so waived by the governmental unit). The market value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. California law also allows financial institutions to secure deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits.

As of June 30, 2010, $819,689 of the District's deposits with financial institutions in excess of federal depository insurance limits were held in collateralized accounts. As of June 30, 2009, $2,454,830 of the District's deposits with financial institutions in excess of federal depository insurance limits were held in collateralized accounts.

2) CASH AND INVESTMENTS - Continued

Local Agency Investment Fund (LAIF)

The District is a voluntary participant in the Local Agency Investment Fund (LAIF) that is regulated by California Government Code Section 16429 under the oversight of the Treasurer of the State of California. The fair value of the District's investment in this pool is reported in the accompanying financial statements at amounts based upon District's pro-rata share of the fair value provided by LAIF for the entire LAIF portfolio (in relation to the amortized cost of that portfolio). The balance available for withdrawal is based on the accounting records maintained by LAIF, which are recorded on an amortized cost-basis.

San Diego County Pooled Fund

The San Diego County Pooled Investment Fund (SDCPIF) is a pooled investment fund program governed by the County of San Diego Board of Supervisors, and administered by the County of San Diego Treasurer and Tax Collector. Investments in SDCPIF are highly liquid as deposits and withdrawals can be made at anytime without penalty.

The County of San Diego's bank deposits are either Federally insured or collateralized in accordance with the California Government Code. Pool detail is included in the County of San Diego Comprehensive Annual Financial Report (CAFR). Copies of the CAFR may be obtained from the County of San Diego Auditor-Controller's Office – 1600 Pacific Coast Highway – San Diego, CA 92101.

Collateral for Deposits

All cash and Certificates of Deposit are entirely insured or collateralized.

Under the provisions of the California Government Code, California banks and savings and loan associations are required to secure the District's deposits by pledging government securities as collateral. The market value of the pledged securities must equal at least 110% of the District's deposits. California law also allows financial institutions to secure District deposits by pledging first trust deed mortgage notes having a value of 150% of the District's total deposits.

The District may waive the 110% collateral requirement for deposits which are insured up to $250,000 by the FDIC.

3) CAPITAL ASSETS

The following is a summary of changes in Capital Assets for the year ended June 30, 2010:

	Beginning Balance	Additions	Deletions	Ending Balance
Capital Assets, Not Depreciated				
Land	$ 13,402,840	$ 280,065	$ (61,942)	$ 13,620,963
Construction in Progress	18,280,278	28,300,354	(9,498,783)	37,081,849
Total Capital Assets Not Depreciated	31,683,118	28,580,419	(9,560,725)	50,702,812
Capital Assets, Being Depreciated				
Infrastructure	537,188,394	8,508,856	(1,163,265)	544,533,985
Field Equipment	9,473,571	422,577	(366,590)	9,529,558
Buildings	18,165,527	299,465	(13,860)	18,451,132
Transportation Equipment	3,284,639	325,228	(331,175)	3,278,692
Communication Equipment	787,358	548,462	-	1,335,820
Office Equipment	17,403,147	1,362,848	(335,607)	18,430,388
Total Capital Assets Being Depreciated	586,302,636	11,467,436	(2,210,497)	595,559,575
Less Accumulated Depreciation:				
Infrastructure	135,582,472	11,462,706	(939,178)	146,106,000
Field Equipment	8,963,959	93,704	(372,084)	8,685,579
Buildings	6,090,921	446,906	(62,686)	6,475,141
Transportation Equipment	2,655,866	149,802	(327,814)	2,477,854
Communication Equipment	410,205	58,343	-	468,548
Office Equipment	10,230,056	1,086,036	(333,472)	10,982,620
Total Accumulated Depreciation	163,933,479	13,297,497	(2,035,234)	175,195,742
Total Capital Assets Being Depreciated, Net	422,369,157	(1,830,061)	(175,263)	420,363,833
Total Capital Assets, Net	$ 454,052,275	$ 26,750,358	$ (9,735,988)	$ 471,066,645

Depreciation expense for the years ended June 30, 2010 and 2009 was $13,297,497 and $12,475,714, respectively.

3) CAPITAL ASSETS (Continued)

The following is a summary of changes in Capital Assets for the year ended June 30, 2009:

	Beginning Balance	Additions	Deletions	Ending Balance
Capital Assets, Not Depreciated:				
Land	$ 13,025,364	$ 377,476	$ -	$ 13,402,840
Construction in Progress	42,338,220	19,496,000	(43,553,942)	18,280,278
Total Capital Assets Not Depreciated	55,363,584	19,873,476	(43,553,942)	31,683,118
Capital Assets, Being Depreciated:				
Infrastructure	495,249,373	42,051,766	(112,745)	537,188,394
Field Equipment	9,430,276	43,295	-	9,473,571
Buildings	17,636,124	529,403	-	18,165,527
Transportation Equipment	3,102,661	194,636	(12,658)	3,284,639
Communication Equipment	689,954	97,404	-	787,358
Office Equipment	16,825,593	577,554	-	17,403,147
Total Capital Assets Being Depreciated	542,933,981	43,494,058	(125,403)	586,302,636
Less Accumulated Depreciation:				
Infrastructure	125,132,713	10,562,504	(112,745)	135,582,472
Field Equipment	8,714,039	249,920	-	8,963,959
Buildings	5,637,685	453,236	-	6,090,921
Transportation Equipment	2,559,141	109,383	(12,658)	2,655,866
Communication Equipment	369,564	40,641		410,205
Office Equipment	9,170,026	1,060,030		10,230,056
Total Accumulated Depreciation	151,583,168	12,475,714	(125,403)	163,933,479
Total Capital Assets Being Depreciated, Net	391,350,813	31,018,344	-	422,369,157
Total Capital Assets, Net	$ 446,714,397	$ 50,891,820	$ (43,553,942)	$ 454,052,275

4) OTHER NONCURRENT ASSETS

Deferred bond issue costs totaled $1,703,282 and $1,142,762, net of accumulated amortization of $295,204 and $296,308 as of June 30, 2010 and 2009, respectively. The costs are amortized on the straight-line method based on the estimated term of the related bond debt. Amortization expense of $66,704 and $56,030 for the years ended June 30, 2010 and 2009 is included in miscellaneous non-operating expenses.

5) LONG-TERM DEBT

Long-term liabilities for the year ended June 30, 2010 are as follows:

	Beginning Balance	Additions	Deletions	Ending Balance	Due Within One Year
General Obligation Bonds:					
Improvement District No. 27 - 1998	$ 8,395,000	$ -	$ 8,395,000	$ -	$ -
Unamortized Bond Discount	(96,159)	-	(96,159)	-	
Deferred Amount on Refunding	(572,266)	-	(572,266)	-	
Improvement District No. 27 - 2009	-	7,780,000	-	7,780,000	520,000
Unamortized Bond Premium	-	209,884	10,903	198,981	-
Deferred Amount on Refunding	-	(728,990)	(33,136)	(695,854)	
Net General Obligation Bonds	7,726,575	7,260,894	7,704,342	7,283,127	520,000
Certificates of Participation:					
1996 Certificates of Participation	12,100,000	-	400,000	11,700,000	400,000
2004 Certificates of Participation	10,320,000	-	530,000	9,790,000	545,000
2007 Certificates of Participation	41,215,000	-	815,000	40,400,000	850,000
1996 COPS Unamortized Discount	(13,413)	-	(745)	(12,668)	
2007 COPS Unamortized Discount	(250,219)	-	(9,044)	(241,175)	
2004 COPS Unamortized Premium	16,500	-	1,165	15,335	
2004 COPS Deferred Amount on Refunding	(174,175)	-	(12,295)	(161,880)	
Net Certificates of Participation	63,213,693	-	1,724,081	61,489,612	1,795,000
Revenue Bonds:					
2010 Water Revenue Bonds Series A		13,840,000	-	13,840,000	
2010 Water Revenue Bonds Series B		36,355,000	-	36,355,000	
2010 Series A Unamortized Premium		1,078,824	18,600	1,060,224	
Net Revenue Bonds	-	51,273,824	18,600	51,255,224	-
Notes Payable:					
State Water Resource Control Board	701,516		341,772	359,744	353,734
Total Long-Term Liabilities	$ 71,641,784	$58,534,718	$ 9,788,795	$120,387,707	$2,668,734

5) LONG-TERM DEBT – Continued

General Obligation Bonds

In June 1998, the District issued $11,835,000 of General Obligation Refunding Bonds. The proceeds of this issue, together with other lawfully available monies, were to be used to establish an irrevocable escrow to advance refund and defease in their entirety the District's previous outstanding General Obligation Bond issue. In November 2009, The District issued $7,780,000 of General Obligation Refunding Bonds to refund the 1998 issue. The proceeds from the bond issue were $7,989,884, which included an original issue premium of $209,884. An amount of $7,824,647, which consisted of unpaid principal and accrued interest, was deposited into an escrow fund. Pursuant to an optional redemption clause in the 1998 bonds, the District was able to redeem the 1998 bonds, without premium at any time after September 1, 2009. On December 15, 2009 the 1998 were refunded.

The savings between the cash flow required to service the old debt and the cash flow required to service the new debt is $1,099,110 and represents an economic gain on refunding of $640,925.

These bonds are general obligations of Improvement District No. 27 (ID 27) of the District. The Board of Directors has the power and is obligated to levy annual ad valorem taxes without limitation, as to rate or amount for payment of the bonds and the interest upon all property which is within ID 27 and subject to taxation. The General Obligation Bonds are payable from District-wide tax revenues. The Board may utilize other sources for servicing the bond debt and interest.

The refunding of the 1998 bonds resulted in a deferred amount of $728,989 which is being amortized over the remaining life of the refunded debt. Amortization for the year ended June 30, 2010 was $33,136 and is included in miscellaneous non-operating expenses. As of June 30, 2010, the unamortized deferred amount of refunding is $695,853.

The 2009 General Obligation Bonds have interest rates from 3.00% to 4.00% with maturities through Fiscal Year 2023.

Future debt service requirements for the bonds are as follows:

For the Year Ended June 30,	Principal	Interest	Total
2011	$ 520,000	$ 267,012	$ 787,012
2012	505,000	251,637	756,637
2013	520,000	236,262	756,262
2014	535,000	220,437	755,437
2015	550,000	204,162	754,162
2016-2020	3,045,000	724,468	3,769,468
2021-2023	2,105,000	127,903	2,232,903
	$ 7,780,000	$ 2,031,881	$ 9,811,881

5) LONG-TERM DEBT - Continued

Certificates of Participation (COPS)

In June 1996, COPS with face value of $15,400,000 were sold by the Otay Service Corporation to finance the cost of design, acquisition, and construction of certain capital improvements. An installment purchase agreement between the District, as Buyer, and the Corporation, as Seller, was executed for the scheduled payment of principal and interest associated with the COPS. The installment payments are to be paid from taxes and "net revenues," as described in the installment agreement. The certificates bear interest at a variable weekly rate not to exceed 12%. The variable interest rate is tied to the 30-day LIBOR index and the Securities Industry and Financial Markets Association (SIFMA) index. The interest rate at June 30, 2010 was 0.25%. The installment payments are to be paid annually at $350,000 to $900,000 from September 1, 1996 through September 1, 2026.

In July 2004, Refunding Certificates of Participation (COPS) with a face value of $12,270,000 were sold by the Otay Service Corporation to advance refund $11,680,000 of outstanding 1993 COPS. An installment agreement between the District, as Buyer, and the Corporation, as Seller, was executed for the scheduled payment of principal and interest associated with the COPS. The installment payments are to be paid from taxes and "net revenues," as described in the installment agreement. The certificates are due in annual installments of $445,000 to $895,000 from September 1, 2005 through September 1, 2023; bearing interest at 3% to 4.625%.

In March 2007, Revenue Certificates of participation (COPS) with face value of $42,000,000 were sold by the Otay Service Corporation to improve the District's water storage system and distribution facilities. An installment purchase agreement between the District, as a Buyer, and the Corporation, as Seller, was executed for the scheduled payment of principal and interest associated with the COPS. The installment payments are to be paid from taxes and "net revenues," as described in the installment agreement. The certificates are due in annual installments of $785,000 to $2,445,000 from September 1, 2007 through September 1, 2036; bearing interest at 3.7% to 4.47%.

There is no aggregate reserve requirement for the COPS. Future debt service requirements for the certificates are as follows:

For the Year	1996 COPS		2004 COPS		2007 COPS	
Ended June 30,	Principal	Interest*	Principal	Interest	Principal	Interest
2011	$ 400,000	$ 28,417	$ 545,000	$ 386,236	$ 850,000	$ 1,655,395
2012	400,000	27,417	565,000	368,607	885,000	1,622,864
2013	500,000	26,208	580,000	349,566	920,000	1,589,020
2014	500,000	24,958	600,000	328,906	955,000	1,553,864
2015	500,000	23,708	625,000	306,388	995,000	1,517,301
2016-2020	3,200,000	95,583	3,505,000	1,133,050	5,580,000	6,979,134
2021-2025	4,100,000	49,708	3,370,000	314,597	6,785,000	5,762,360
2026-2030	2,100,000	3,626	-		8,335,000	4,192,867
2031-2035	-	-	-	-	12,650,000	2,208,438
2036-2038	-	-	-	-	2,445,000	211,640
	$11,700,000	$ 279,625	$ 9,790,000	$ 3,187,350	$40,400,000	$27,292,883

* Variable Rate - Interest reflected at June 30, 2010 at a rate of 0.25%.

The three COP debt issues contain various covenants and restrictions, principally that the District fix, prescribe, revise and collect rates, fees and charges for the Water System which will be at least sufficient to yield, during each fiscal year, taxes and net revenues equal to one hundred twenty-five percent (125%) of the debt service for such fiscal year. The District was in compliance with these rate covenants for the fiscal year ended June 30, 2010.

5) LONG-TERM DEBT - Continued

Water Revenue Bonds

In April 2010, Water Revenue Bonds with a face value of $50,195,000 were sold by the Otay Water District Financing Authority to provide funds for the construction of water storage and transmission facilities. The bond issue consisted of two series; Water Revenue Bonds, Series 2010A (Non-AMT Tax Exempt) with a face value of $13,840,000 plus a $1,078,824 original issue premium, and Water Revenue Bonds Series 2010B (Taxable Build America Bonds) with a face value of $36,255,000. The Series 2010A bonds are due in annual installments of $785,000 to $1,295,000 from September 1, 2011 through September 1, 2025; bearing interest at 2% to 5.25%. The Series 2010B bonds are due in annual installments of $1,365,000 to $3,505,000 from September 1, 2026 through September 1, 2040; bearing interest at 6.377% to 6.577%. Interest on both Series is payable on September 1, 2010 and semiannually thereafter on March 1st and September 1st of each year until maturity or earlier redemption. The installment payments are to be made from Taxes and Net Revenues of the Water System as described in the installment purchase agreement, on parity with the payments required to be made by the District for the 1996, 2004 and 2007 Certificates of Participation described above.

The proceeds of the bonds will be used to fund the project described above as well as to fund reserve funds of $1,030,688 (Series 2010A) and $2,707,418 (Series 2010B). $542,666 was used to fund various costs of issuance.

The original issue premium is being amortized over the 14 year life of the Series 2010A bonds. At June 30, 2010 $18,600 has been amortized and is included in interest expense. The unamortized premium at June 30, 2010 is $1,060,224.

The 2010 Water Revenue Bonds contains various covenants and restrictions, principally that the District fix, prescribe, revise and collect rates, fees and charges for the Water System which will be at least sufficient to yield, during each fiscal year, taxes and net revenues equal to one hundred twenty-five percent (125%) of the debt service for such fiscal year. The District was in compliance with these rate covenants for the fiscal year ended June 30, 2010.

The total amount outstanding at June 30, 2010 and aggregate maturities of the revenue bonds for the fiscal years subsequent to June 30, 2010, are as follows:

For the Year	2010 Water Revenue Bond Series A		2010 Water Revenue Bond Series B	
Ended June 30,	Principal	Interest	Principal	Interest
2011	$ -	$ 498,928	$ -	$ 2,049,031
2012	785,000	569,688	-	2,371,868
2013	800,000	553,838	-	2,371,868
2014	820,000	533,538	-	2,371,868
2015	845,000	508,563	-	2,371,868
2016-2020	4,700,000	2,018,963	-	11,859,342
2021-2025	5,890,000	779,567	-	11,859,342
2026-2030	-	-	7,745,000	10,685,177
2031-2035	-	-	10,570,000	7,756,703
2036-2040	-	-	14,535,000	3,664,211
2041	-	-	3,505,000	115,262
	$ 13,840,000	$ 5,463,085	$ 36,355,000	$ 57,476,540

5) LONG-TERM DEBT - Continued

Note Payable

In December 1990, the District entered into a 3.5% note payable to the State Water Resources Control Board. This note is unsecured and payable in annual installments of $366,325 including principal and interest from 1992 through 2012. The total amount outstanding at June 30, 2010 and aggregate maturities of the note for the fiscal years subsequent to June 30, 2010, are as follows:

For the Year Ended June 30,	Principal	Interest
2011	$ 353,734	$ 12,591
2012	6,010	1
	$ 359,744	$ 12,592

6) NET ASSETS

Designated Net Assets

In addition to the restricted net assets, a portion of the unrestricted net assets have been designated by the Board of Directors for the following purposes as of June 30, 2010 and 2009:

	2010	2009
Designated Betterment	$ 6,653,909	$ 2,969,722
Expansion Reserve	21,096,749	18,569,610
Replacement Reserve	24,483,877	26,388,812
Insurance Reserve	6,639,953	8,436,721
Total	$ 58,874,488	$ 56,364,865

7) DEFINED BENEFIT PENSION PLAN

Plan Description

The District's defined plan, (the "Plan"), provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. The Plan is part of the Public Agency portion of the California Public Employees' Retirement System (CalPERS), an agent multiple-employer plan administered by CalPERS, which acts as a common investment and administrative agent for participating public employers within the State of California. A menu of benefit provisions as well as other requirements is established by State statute within the Public Employees' Retirement Law. The Plan selects optional benefit provisions from the benefit menu by contract with CalPERS and adopts those benefits through District resolution. CalPERS issues a separate Comprehensive Annual Financial Report. Copies of the CalPERS' annual financial report may be obtained from the CalPERS Executive Office, 400 P Street, Sacramento, California 95814.

7) DEFINED BENEFIT PENSION PLAN - Continued

Funding Policy

Active members in the Plan are required to contribute 8% of their annual covered salary. The District has elected to contribute 7% on behalf of its employees. The District is required to contribute the actuarially determined remaining amounts necessary to fund the benefits for its members. The actuarial methods and assumptions used are those adopted by the CalPERS Board of Administration. The required employer contribution rate for the fiscal year ended June 30, 2010 was 19.815%. The contribution requirements of the Plan members are established by State statute and the employer contribution rate is established and may be amended by the CalPERS.

Annual Pension Costs

For the fiscal year ended June 30, 2010, the District's annual pension cost and actual contribution was $2,240,538. The required contribution for the fiscal year ended June 30, 2010 was determined as part of the June 30, 2007 actuarial valuation.

The following is a summary of the actuarial assumptions and methods:

Valuation Date	June 30, 2007
Actuarial Cost Method	Entry Age Actuarial Cost Method
Amortization Method	Level Percent of Payroll
Average Remaining Period	20 Years as of the Valuation Date
Asset Valuation Method	15 Year Smoothed Market
Actuarial Assumptions:	
Investment Rate of Return	7.75% (Net of Administrative Expenses)
Projected Salary Increase	3.25% to 14.45% Depending on Age, Service, and Type of Employment
Inflation	3.00%
Payroll Growth	3.25%
Individual Salary Growth	A merit scale varying by duration of employment coupled with an assumed annual inflation component of 3.00% and an annual production growth of 0.25%.

Initial unfunded liabilities are amortized over a closed period that depends on the Plan's date of entry into CalPERS. Subsequent Plan amendments are amortized as a level percentage of pay over a closed 20-year period. Gains and losses that occur in the operation of the plan are amortized over a rolling period, which results in an amortization of 6% of unamortized gains and losses each year. If the plan's accrued liability exceeds the actuarial value of the plan assets, then the amortization payment of the total unfunded liability may be lower than the payment calculated over a 30-year amortization period.

THREE-YEAR TREND INFORMATION FOR PERS

Fiscal Year	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
6/30/10	$ 2,240,538	100%	$ 0
6/30/09	$ 2,150,579	100%	$ 0
6/30/08	$ 2,252,601	100%	$ 0

Funded Status and Funding Progress

As of June 30, 2008, the most recent actuarial valuation date, the plan was 75.8% funded. The actuarial accrued liability (AAL) for benefits was $65,542,736, and the actuarial value of assets was $49,712,016, resulting in an unfunded actuarial accrued liability (UAAL) of $15,830,720. The covered payroll (annual payroll of active employees covered by the plan) was $11,174,528, and the ratio of the UAAL to the covered payroll was 141.7%.

The schedule of funding progress, presented as *required supplementary information* following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over the time relative to the actuarial accrued liability for benefits.

8) OTHER POST EMPLOYMENT BENEFITS

Plan Description

The District's defined benefit postemployment healthcare plan, (DPHP), provides medical benefits to eligible retired District employees and beneficiaries. DPHP is part of the Public Agency portion of the California Employers' Retiree Benefit Trust Fund (CERBT), an agent multiple-employer plan administered by California Public Employees' Retirement System (CalPERS), which acts as a common investment and administrative agent for participating public employers within the State of California. A menu of benefit provisions as well as other requirements is established by State statute within the Public Employees' Retirement Law. DPHP selects optional benefit provisions from the benefit menu by contract with CalPERS and adopts those benefits through District resolution. CalPERS issues a separate Comprehensive Annual Financial Report. Copies of the CalPERS' annual financial report may be obtained from the CalPERS Executive Office, 400 P Street, Sacramento, California 95814.

Funding Policy

The contribution requirements of plan members and the District are established and may be amended by the Board of Directors. DPHP members receiving benefits contribute based on their selected plan options of EPO, Silver or Gold and if they are located outside the State of California. Contributions by plan members range from $0 to $95 per month for coverage to age 65, and from $0 to $62 per month, respectively, thereafter.

Annual OPEB Cost and Net OPEB Obligation/Asset

The District's annual OPEB cost (expense) is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis is projected to cover the normal annual cost. Any unfunded actuarial liability (or funding excess) is amortized over a period not to exceed thirty years. The current ARC rate is 2.9% of the annual covered payroll.

The following table shows the components of the District's annual OPEB cost for the year, the amount actually contributed to the plan, and changes in the District's net OPEB obligation/asset:

	2010	2009
Annual Required Contribution (ARC)	$ 345,000	$ 873,000
Interest on net OPEB asset	(480,878)	(437,798)
Adjustment to Annual Required Contribution (ARC)	591,000	489,999
Annual OPEB cost	455,122	925,201
Contributions made	1,033,631	1,481,069
Increase in net OPEB asset	(578,509)	(555,868)
Net OPEB asset - beginning of year	(6,204,876)	(5,649,008)
Net OPEB asset - end of year	$ (6,783,385)	$ (6,204,876)

For 2010, in addition to the ARC, the District contributed an implied subsidy (healthcare premium payments for retirees to Special District Risk Management Authority (SDRMA)) in the amount of $597,631, which is included in the $1,033,631 of contributions shown above. For 2009 this amount was $608,069, which is included in the $1,481,069 of contributions shown above.

8) OTHER POST EMPLOYMENT BENEFITS - Continued

The District's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation/asset for the fiscal years 2010, 2009 and 2008 were as follows:

THREE-YEAR TREND INFORMATION FOR CERBT

Fiscal Year	Annual OPEB Cost (AOC)	Percentage of OPEB Cost Contributed	Net OPEB Asset
6/30/2010	$ 455,122	100%	$ (6,783,385)
6/30/2009	$ 925,201	100%	$ (6,204,876)
6/30/2008	$ 846,000	100%	$ (5,649,008)

Funded Status and Funding Progress

The funded status of the plan as of June 30, 2009, the most recent actuarial valuation date, was as follows:

Actuarial Accrued Liability (AAL)	$ 10,070,000
Actuarial Value of Plan Assets	$ 6,273,000
Unfunded Actuarial Accrued Liability (UAAL)	$ 3,797,000
Funded Ratio (Actuarial Value of Plan Assets/AAL)	62.29%
Covered Payroll (Active Plan Members)	$ 11,878,000
UAAL as a Percentage of Covered Payroll	31.97%

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for the benefits.

8) OTHER POST EMPLOYMENT BENEFITS - Continued

Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial assets, consistent with the long-term perspective of the calculations.

The following is a summary of the actuarial assumptions and methods:

Valuation Date	June 30, 2009
Actuarial Cost Method	Entry Age Normal Cost Method
Amortization Method	Level Percent of Payroll
Remaining Amortization Period	28 Years as of the Valuation Date
Asset Valuation Method	15 Year Smoothed Market
Actuarial Assumptions:	
Investment Rate of Return	7.75% (Net of Administrative Expenses)
Projected Salary Increase	3.25%
Inflation	3.00%
Individual Salary Growth	CalPERS 1997-2002 Experience Study

9) WATER CONSERVATION AUTHORITY

In 1999 the District formed the Water Conservation Authority (the "Authority"), a Joint Powers Authority, with other local entities to construct, maintain and operate a xeriscape demonstration garden in the furtherance of water conservation. The authority is a non-profit public charity organization and is exempt from income taxes. During the years ended June 30, 2010 and 2009, the District contributed $100,240 and $95,270, respectively, for the development, construction and operation costs of the xeriscape demonstration garden.

A summary of the Authority's June 30, 2009 audited financial statement is as follows (latest report available):

Assets	$ 2,388,402
Liabilities	52,488
Revenues, Gains and Other Support	719,224
Changes in Net Assets	(100,318)

10) COMMITMENTS AND CONTINGENCIES

Construction Commitments

The District had committed to capital projects under construction with an estimated cost to complete of $1,049,789 at June 30, 2010.

Litigation

Certain claims, suits and complaints arising in the ordinary course of operation have been filed or are pending against the District. In the opinion of the staff and counsel, all such matters are adequately covered by insurance, or if not so covered, are without merit or are of such kind, or involved such amounts, as would not have significant effect on the financial position or results of operations of the District if disposed of unfavorably.

Refundable Terminal Storage Fees

The District has entered into an agreement with several developers whereby the developers prepaid the terminal storage fee in order to provide the District with the funds necessary to build additional storage capacity. The agreement further allows the developers to relinquish all or a portion of such water storage capacity. If the District grants to another property owner the relinquished storage capacity, the District shall refund to the applicable developer $746 per equivalent dwelling unit (EDU). There were 17,867 EDUs that were subject to this agreement. At June 30, 2009, 1,750 EDUs had been relinquished and refunded, 14,662 EDUs had been connected, and 1,455 EDUs have neither been relinquished nor connected. At June 30, 2010, 1,751 EDUs had been relinquished and refunded, 14,663 EDUs had been connected, and 1,453 EDUs have neither been relinquished nor connected.

Developer Agreements

The District has entered into various Developer Agreements with developers towards the expansion of District facilities. The developers agree to make certain improvements and after the completion of the projects the District agrees to reimburse such improvements with a maximum reimbursement amount for each developer. Contractually, the District does not incur a liability for the work until the work is accepted by the District. As of June 30, 2010, none of the outstanding developer agreements had been accepted, however it is anticipated that the District will be liable for an amount not to exceed $20,300 at the point of acceptance. Accordingly, the District did not accrue a liability as of year end.

11) RISK MANAGEMENT

General Liability

The District is exposed to various risks of loss related to torts, theft, damage and destruction of assets, errors and omissions, and natural disasters. Beginning in July 2003, the District began participation in an insurance pool through the Special District Risk Management Authority (SDRMA). SDRMA is a not-for-profit public agency formed under California Government Code Sections 6500 et. Seq. SDRMA is governed by a board composed of members from participating agencies. The mission of SDRMA is to provide renewable, efficiently priced risk financing and risk management services through a financially sound pool. The District pays an annual premium for commercial insurance covering general liability, excess liability, property, automobile, public employee dishonesty, and various other claims. Coverage limits range up to $1 billion. Accordingly, the District retains no risk of loss. Separate financial statements of SDRMA may be obtained at Special District Risk Management Authority, 1112 "I" Street, Suite 300, Sacramento, CA 95814.

Workers' Compensation

Through SDRMA, the District is insured up to $200,000,000 for Statutory Workers' Compensation and $5,000,000 for Employers' Liability coverage with no deductible. SDRMA currently has a pool of 348 agencies in the Workers' Compensation Program.

11) RISK MANAGEMENT - Continued

Health Insurance

Beginning in January 2008, the District began providing health insurance through SDRMA covering all of its employees, retirees, and other dependents. SDRMA is a self-funded, pooled medical program, administered in conjunction with the California State Association of Counties (CSAC).

Adequacy of Protection

During the past three fiscal (claims) years none of the above programs of protection have had settlements or judgments that exceeded pooled or insured coverage. There have been no significant reductions in pooled or insured liability coverage from coverage in the prior year.

12) INTEREST EXPENSE

Interest expense for the years ended June 30, 2010 and 2009, is as follows:

	2010	2009
Amount Expensed	$ 2,404,530	$ 1,340,110
Amount Capitalized as a Cost of Construction Projects	510,115	1,353,153
Total Interest	$ 2,914,645	$ 2,693,263

13) SEGMENT INFORMATION

During the June 30, 2010 fiscal year, the District issued Revenue Bonds to finance certain capital improvements. While water and wastewater services are accounted for in a single fund in these financial statements, the investors in the Revenue Bonds rely solely on the revenues of the water services for repayment.

Summary financial information for the water services is presented for June 30, 2010.

Condensed Statement of Net Assets
June 30, 2010

	Water Services
ASSETS	
Current Assets	$ 126,774,856
Capital Assets	455,162,484
Other Assets	8,486,667
Total Assets	590,424,007
LIABILITIES	
Current Liabilities	23,980,259
Long-Term Liabilities	118,389,772
Total Liabilities	142,370,031
NET ASSETS	
Invested in capital assets, net of related debt	362,311,370
Restricted for debt service	5,192,111
Unrestricted	80,550,495
Total Net Assets	$ 448,053,976

13) SEGMENT INFORMATION - Continued

Condensed Statement of Revenues, Expenses and Changes in Net Assets For The Year Ended June 30, 2010

	Water Services
Operating Revenues	
Water sales	$ 56,210,109
Connection and other fees	1,907,797
Total Operating Revenues	58,117,906
Operating Expenses	
Cost of Water Sales	39,338,495
Administrative and General	17,750,713
Depreciation	12,495,217
Total Operating Expenses	69,584,425
Operating Income (Loss)	(11,466,519)
Nonoperating Revenues (Expenses)	
Investment income	1,323,844
Taxes and assessments	3,613,901
Availability charges	618,806
Gain (loss) on sale of capital assets	(143,086)
Miscellaneous revenues	2,921,016
Donations	(100,240)
Interest expense	(2,386,955)
Miscellaneous expenses	(303,963)
Total Nonoperating Revenues (Expenses)	5,543,323
Income (Loss) Before Capital Contributions	(5,923,196)
Capital Contributions	8,948,920
Changes in Net Assets	3,025,724
Total Net Assets, Beginning	445,028,252
Total Net Assets, Ending	$ 448,053,976

13) SEGMENT INFORMATION - Continued

Condensed Statement of Cash Flows

For The Year Ended June 30, 2010

	Water Services
Net Cash Provided by Operating Activities	$ 4,856,836
Net Cash Provided by Noncapital and Related Financing Activities	4,747,692
Net Cash Provided by Capital and Related Financing Activities	25,787,143
Net Cash Used by Investing Activities	(26,663,096)
Net Increse in Cash and Cash Equivalents	8,728,575
Cash and cash equivalents, Beginning	52,583,868
Cash and cash equivalents, Ending	$ 61,312,443

REQUIRED SUPPLEMENTARY INFORMATION
YEARS ENDED JUNE 30, 2010 AND 2009

Schedule of Funding Progress for PERS

Actuarial Valuation Date	Actuarial Value of Assets (A)	Actuarial Accrued Liability (AAL) Entry Age (B)	Unfunded AAL (UAAL) (B - A)	Funded Ratio (A/B)	Covered Payroll (C)	UAAL as a Percentage of Covered Payroll [(B-A)/C]
6/30/08 Miscellaneous	$ 49,712,016	$ 65,542,736	$ 15,830,720	75.8%	$ 11,174,528	141.7%
6/30/07 Miscellaneous	$ 44,910,326	$ 59,412,116	$ 14,501,790	75.6%	$ 10,663,440	136.0%
6/30/06 Miscellaneous	$ 40,321,483	$ 54,228,041	$ 13,906,558	74.4%	$ 10,470,766	132.8%

Schedule of Funding Progress for DPHP

Actuarial Valuation Date	Actuarial Value of Assets (A)	Actuarial Accrued Liability (AAL) Entry Age (B)	Unfunded AAL (UAAL) (B - A)	Funded Ratio (A/B)	Covered Payroll (C)	UAAL as a Percentage of Covered Payroll [(B-A)/C]
6/30/09 Miscellaneous	$ 6,273,000	$ 10,070,000	$ 3,797,000	62.29%	$ 11,878,000	31.97%
6/30/08 Miscellaneous	$ 5,649,000	$ 11,581,000	$ 5,932,000	48.78%	$ 11,307,000	52.5%
6/30/07 Miscellaneous	$ 0	$ 11,408,000	$ 11,408,000	0%	$ 10,951,000	104.20%

Attachment C

DIEHL, EVANS & COMPANY, LLP
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* A PROFESSIONAL CORPORATION

October 12, 2010

Board of Directors
Otay Water District
Spring Valley, California

In planning and performing our audit of the financial statements of the Otay Water District (the District) as of and for the year ended June 30, 2010, in accordance with auditing standards generally accepted in the United States of America, we considered the District's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we do not express an opinion on the effectiveness of the District's internal control.

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

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and, therefore, there can be no assurance that all such deficiencies have been identified. We did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined above.

This communication is intended solely for the information and use of management, the Board of Directors, and others within the District and is not intended to be and should not be used by anyone other than these specified parties.

Diehl, Evans and Company, LLP

Attachment D

DIEHL, EVANS & COMPANY, LLP

CERTIFIED PUBLIC ACCOUNTANTS & CONSULTANTS

A PARTNERSHIP INCLUDING ACCOUNTANCY CORPORATIONS

2965 ROOSEVELT STREET
CARLSBAD, CALIFORNIA 92008-2389
(760) 729-2343 • FAX (760) 729-2234
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NITIN P. PATEL, CPA
ROBERT J. CALLANAN, CPA

* A PROFESSIONAL CORPORATION

October 12, 2010

The Board of Directors and
Management of the Otay Water District
Spring Valley, California

In planning and performing our audit of the financial statements of the Otay Water District (District) as of and for the year ended June 30, 2010, in accordance with auditing standards generally accepted in the United States of America, we considered the District's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we do not express an opinion on the effectiveness of the District's internal control.

However, during our audit we became aware of a certain matter that we would like to bring to your attention. This matter is set forth below, together with our recommendation.

Interest Capitalization

During our audit it was noted that the capitalization of interest on certain construction projects relating to the 2010 Water Revenue Bonds was understated by $436,369. The District's interest capitalization calculation for the 2010 Water Revenue Bonds was based on an interest capitalization accounting principle (FASB 34) that was being properly applied to other District debt. The accounting principle that applies to the 2010 Water Revenue Bonds (FASB 62) requires a different calculation of the amount of interest to be capitalized. We recommend the District review any new interest capitalization with the District's auditor during the year.

This communication is intended solely for the information and use of management, the Board of Directors, and others within the District and is not intended to be, and should not be, used by anyone other than these specified parties.

Diehl, Evans and Company, LLP

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* A PROFESSIONAL CORPORATION

October 12, 2010

Board of Directors
Audit Committee
Otay Water District
Spring Valley, California

We have audited the financial statements of the Otay Water District for the year ended June 30, 2010, and have issued our report thereon dated October 12, 2010. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility Under Auditing Standards Generally Accepted in the United States of America:

As stated in our engagement letter dated February 5, 2010, our responsibility, as described by professional standards, is to express an opinion about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with accounting principles generally accepted in the United States of America. Our audit of the financial statements does not relieve you or management of your responsibilities. Our responsibility is to plan and perform the audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement. As part of our audit, we considered the internal control of the Otay Water District. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control. We are responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures specifically to identify such matters.

Planned Scope and Timing of the Audit:

We performed the audit according to the planned scope and timing previously communicated to you in our meeting about planning matters on August 25, 2010.

OTHER OFFICES AT:

613 W. VALLEY PARKWAY, SUITE 330
ESCONDIDO, CALIFORNIA 92025-2598
(760) 741-3141 • FAX (760) 741-9890

5 CORPORATE PARK, SUITE 100
IRVINE, CALIFORNIA 92606-5165
(949)-399-0600 • FAX (949) 399-0610

Significant Audit Findings:

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the Otay Water District are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year ended June 30, 2010. We noted no transactions entered into by the Otay Water District during the year for which there is a lack of authoritative guidance or consensus. There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements were:

a. Management's estimate of the fair market value of investments which is based on market values by outside sources.

b. The estimated useful lives for capital assets which are based on industry standards.

c. The annual required contribution for the District's Other Post-Employment Benefits was prepared by an outside consultant.

We evaluated the key factors and assumptions used to develop these estimates in determining that they were reasonable in relation to the financial statements taken as a whole.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Audit Adjustments

Professional standards require us to accumulate all known and likely adjustments identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. Management has made all such adjustments. The following adjustment detected as a result of audit procedures was corrected by management:

a. Capitalized interest on infrastructure capital assets was increased by $436,369 due to the adjustment. We determined the proper amount to be capitalized through calculations of capital assets constructed.

Significant Audit Findings (Continued):

Disagreements with Management

For the purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements of the auditors' report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated October 12, 2010.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involved application of an accounting principle to the Otay Water District's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management prior to retention as the Otay Water District's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

****

This information is intended solely for the use of the Board of Directors, Audit Committee and management of the Otay Water District and is not intended to be and should not be used by anyone other than these specified parties.

Diehl, Evans and Company, LLP

Attachment F

DIEHL, EVANS & COMPANY, LLP

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INDEPENDENT ACCOUNTANTS' REPORT ON APPLYING AGREED-UPON PROCEDURES

October 13, 2010

Mr. Joseph Beachem
Chief Financial Officer
Otay Water District
Spring Valley, CA

We have performed the procedures enumerated below, which were agreed to by the Otay Water District (the "District") solely to assist the District's senior management in evaluating the investments of the District for the fiscal year ended June 30, 2010. The District's management is responsible for the evaluation of the investments of the District. This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of those parties specified in the report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

Our procedures and findings are as follows:

1. Obtain a copy of the District's investment policy and determine that it is in effect for the time period under review.
    a. Findings: At June 30, 2010, the current investment policy (Policy #27) is dated September 6, 2006. This policy was reviewed and approved for the 2009/2010 Fiscal year as part of the consent calendar at the September 2, 2009 Regular Board Meeting. Therefore the investment policy is in effect for the time period under review.

2. Select 4 investments held at year end and determine if they are allowable investments under the District's Investment Policy.
    a. Findings: Four investments chosen were FNMA – Maturity 10/5/2012; FHLB – Maturity 9/21/2012; FHLMC – Maturity 6/08/2012 and GE Electric Corporate Bond – Maturity 12/1/2010. All four investments are allowable and within maturity limits as stated in the District's Investment Policy at June 30, 2010.

3. For the four investments selected in #2 above, determine if they are held by a third party custodian designated by the District.
    a. Findings: Per discussion with District management and evidenced by Union Bank of California monthly statements, the four investments examined are held by a third party custodian designated by the District in compliance with District Policy.

4. Confirm the par or original investment amount and market value for the four investments selected above with the custodian or issuer of the investments.
    a. Findings: Investment values confirmed with Union Bank of California at June 30, 2010 with no exceptions.

5. Select two investment earnings transactions that took place during the year and recompute the earnings to determine if the proper amount was received.
    a. Findings: Investment earnings recalculated with no exceptions for two transactions selected.

6. Trace amounts received for transactions selected at #5 above into the District's bank accounts.
    a. Transactions traced into District's Union Bank of California Money Market account with no exceptions for the two transactions selected.

7. Select five investment transactions (buy, sell, trade or maturity) occurring during the year under review and determine that the transactions are permissible under the District's investment policy.
    a. Findings: Reviewed five investment transactions. All transactions were permissible under the District's Investment Policy.

8. Review the supporting documents for the five investments selected at #7 above to determine if the transactions were appropriately recorded in the District's general ledger.
    a. Findings: Five investments selected at #7 above are appropriately recorded in the District's General Ledger without exception.

We were not engaged to, and did not, conduct an audit, the objective of which would be the expression of an opinion on the investments of the District for the fiscal year ending June 30, 2010. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is limited solely for the information and use of the Board and senior management of the Otay Water District and is not intended to be and should not be used by anyone other than those specified parties.

Diehl, Evans and Company, LLP

AGENDA ITEM 4

STAFF REPORT

TYPE MEETING:	Regular Board	MEETING DATE:	November 3, 2010
SUBMITTED BY:	Rita Bell, Finance Manager	W.O./G.F. NO:	DIV. NO. All
APPROVED BY: (Chief)	Joseph R. Beachem, Chief Financial Officer		
APPROVED BY: (Asst. GM):	German Alvarez, Assistant General Manager, Administration and Finance		
SUBJECT:	Adopt Resolution No. 4162 of the District's Code of Ordinances Amending Policy No. 25, the Reserve Policy, Which Includes the Updated Capacity Fees and Annexation Fees, and the New Water Supply Fee		

GENERAL MANAGER'S RECOMMENDATION:

That the Board adopt Resolution No. 4162 of the District's Code of Ordinances amending Policy No. 25, the Reserve Policy, which includes the updated capacity fees and annexation fees, and the new water supply fee.

COMMITTEE ACTION:

Please see Attachment A.

PURPOSE:

That the Board adopt Resolution No. 4162 of the District's Code of Ordinances amending Policy No. 25, the Reserve Policy, which includes the updated capacity fees and annexation fees, and the new water supply fee.

ANALYSIS:

In March 2006, the Reserve Policy was updated to reflect industry best practices, clearly defining the sources and uses of the District's funds and establishing the minimums, maximums, and targets for each of the funds. In May 2010, the Board adopted a new capacity fee and annexation fee methodology, as well as a new water supply fee. As a result of these Board approved changes, the new sources and uses of fees need to be incorporated into the Reserve Policy.

The proposed policy is in alignment with the District's financial plan and is an integral part of the annual rate model update which impacts the District's rates and fees.

FISCAL IMPACT:

None.

STRATEGIC GOAL:

The District ensures its continued financial health through long-term financial planning and debt planning.

LEGAL IMPACT:

None.

General Manager

Attachments:

A) Committee Action Form
B) Resolution No. 4162
   Exhibit 1 Strike-through Copy of Policy No. 25
C) Proposed Copy of Policy No. 25

ATTACHMENT A

SUBJECT/PROJECT:	Adopt Resolution No. 4162 of the District's Code of Ordinances Amending Policy No. 25, the Reserve Policy, Which Includes the Updated Capacity and Annexation Fees, and the New Water Supply Fee

COMMITTEE ACTION:

The Finance, Administration, and Communications Committee recommend that the Board adopt Resolution No. 4162 of the District's Code of Ordinances amending Policy No. 25, the Reserve Policy, which includes the updated capacity and annexation fees and the new water supply fee.

NOTE:

The "Committee Action" is written in anticipation of the Committee moving the item forward for board approval. This report will be sent to the Board as a committee approved item, or modified to reflect any discussion or changes as directed from the committee prior to presentation to the full board.

RESOLUTION NO.4162

A RESOLUTION OF THE BOARD OF DIRECTORS OF THE
OTAY WATER DISTRICT AMENDING
RESERVE POLICY NO.25 OF THE
DISTRICT'S CODE OF ORDINANCES

WHEREAS, the Otay Water District Board of Directors have been presented with an amended Reserve Policy No. 25 of the District's Code of Ordinances for the financial management of the Otay Water District; and

WHEREAS, the amended Reserve Policy has been reviewed and considered by the Board, and it is in the interest of the District to adopt the amended Reserve Policy; and

WHEREAS, the strike-through copy of the proposed policy is attached as Exhibit 1 to this resolution; and

NOW, THEREFORE, BE IT RESOLVED, DETERMINED AND ORDERED by the Board of Directors of the Otay Water District that the amended Reserve Policy, incorporated herein as an attachment, is hereby adopted.

PASSED, APPROVED AND ADOPTED by the Board of Directors of Otay Water District at a board meeting held this 3rd day of November 2010, by the following vote:

Ayes:
Noes:
Abstain:
Absent:

____
President

ATTEST:

____
District Secretary

OTAY WATER DISTRICT **BOARD OF DIRECTORS POLICY**			
Subject	Policy Number	Date Adopted:	Date Revised
RESERVE POLICY	25	2/10/93	~~3/13/06~~ 11/3/10

~~**INTRODUCTION**~~

1.0 The District

The Otay Water District is ~~a publicly-owned water and sewer service agency, more specifically,~~ a California ~~special~~ municipal water district, authorized in 1956 by the State Legislature under the provisions of the Municipal Water District Act of 1911. The District is a "revenue neutral" public agency~~,~~; meaning each end user pays ~~its~~ their fair share of the District's costs of water acquisition, construction of infrastructure, and the operation and maintenance of the public water facilities.

The District provides water service within its boundaries, and provides sewer and recycled water service within certain portions of the District. As such, ~~T~~the District operates three distinct business segments:

- Potable water
- Recycled water
- Sewer

Each of these business segments has ~~a distinct~~ an identifiable customer base. In addition, the developer community, large and small, makes up a significant class of customer for each business segment. As a result, the District has four distinct customer service types:

- Developers
- Potable water users
- Recycled water users
- Sewer users

The District has established practices and developed computer systems that have enabled the District to maintain a clear separation between the~~se~~ service costs relating to each of its four customer service types. Regardless of customer class, financial principles regarding cost allocation and fund accounting are fundamental to the District's Reserve Policy. These principles are derived from the statements of the Governmental Accounting Standards Board (GASB), and from oversight and advisory bodies such as the California State Auditor, the Little Hoover Commission, and the Government Finance Officers Association (GFOA). These have significant impacts on how the finances of the District are organized and how financial processes work within the organization.

1.1 The District's Use of ~~Funds~~Financial Resources

All of the District's expenditures fall into two broad categories: operating costs and capital expenditures. The ~~O~~operating costs include costs relating to ~~and Maintenance (O&M) expenditures generally support~~ the purchase and delivery of potable and recycled water, and the transportation and treatment of sewage. The capital expenditures support the construction of infrastructure necessary to deliver service. The District uses various ~~reserves~~ funds to support the operating and capital efforts. Operations and maintenance is financed only by rates and charges, also called ~~Capital infrastructure is funded using two methods:~~ pay-as-you-go, while capital infrastructure is financed using two financing methods: pay-as-you-go and ~~or~~ debt issuance (requiring annual debt service). The Capital Improvement Program (CIP) and the two funding methods support the construction, betterment, and replacement of infrastructure in all three business areas: potable, recycled, and sewer. ~~Both the capital and operating efforts within the District are different for each of the four distinct customer types.~~

The District ~~uses a set of~~ establishes different funds to accumulate and account for revenues allocated to different activities. Those funds receive funding up to the levels defined in this policy. ~~Each~~ Every year, as a part of the annual budget process, the District's rate model is updated for each fund with the current fund balances and the estimated revenues and expenditures for the next six years. The expenditure ~~or funding~~ requirements and financial resources are then evaluated to ensure that the existing fund ~~levels~~ balances and additional revenues are sufficient within the current budget cycle and for the next five years to maintain target fund levels. If a deficit is identified, then options for transfers, shifting CIP projects, debt, cost saving measures, and/or rate increases are evaluated.

1.2 The District's Capital Improvement Program (CIP)

The planning, design, and construction costs of all capital facilities within the three business segments are allocated to ~~three~~ four cost ~~areas~~types ~~:~~ and corresponding fund categories: New Water Supply, Expansion, Replacement~~Betterment~~, and/or ~~Replacement~~ Betterment. The ~~funding~~ allocation ~~for~~ to these ~~three~~ four cost ~~areas~~ types is defined in the District's Capital Improvement Program (CIP) and is determined by an engineering analysis ~~which~~ that identifies which type of customer~~s~~ will benefit from ~~the~~ each facility, planned or existing. The costs of the capital improvements are borne by either existing users or by the developing areas, or by a combination of the two, as applicable.~~Expansion is for new customers, betterment is for existing customers where the facility is improved, and replacement is for existing customers where the facility is replaced. If an expansion capital project also results in betterment or replacement, the costs are allocated to new users (Expansion) and existing users (Betterment and Replacement) so that the developers will only pay the expansion portions.~~

This Reserve ~~p~~Policy protects both the existing users and the developing ~~and established~~ areas from incurring ~~inappropriate~~ unwarranted costs. –Developing areas are not required to finance facilities that are ~~due for~~ replacement or betterment~~; conversely,~~ and established areas are not required to replace facilities before they are worn out ~~simply~~ because of new development. However, to ensure a fair allocation of costs, ~~E~~each facility has the potential to be classified into any or all of the four cost types.~~three categories to various degrees.~~ In addition to these ~~standard categories~~ cost types, there are occasional CIPs that may be billable to a third party, ~~such as relocations.~~ if for example, a third party requires a District facility be relocated. Paragraphs a through d below, describe how the costs of capital facilities are financed through various fees.

a. ~~a.~~ New Water Supply
The portion of a new supply project that benefits new users is financed from the reserves in the New Water Supply Fund category. These reserves are primarily derived from proceeds of the new water supply fee. The New Water Supply Fund is restricted, meaning the amounts credited to this fund are accounted for separately and are used solely for the planning, design, and construction of the new water supply expansion facilities. Debt financing may also be a temporary financial resource to finance new water supply projects. The District has a Debt Policy (Policy No. 45) that guides the debt issuance process. Any debt proceeds used for this purpose would be restricted in nature and tracked separately. General use reserves may also be placed in the Designated New Water Supply Fund and used for water supply projects.

b. Expansion ~~Fund~~
The portion of a CIP project that benefits new users is ~~funded~~ financed~~by the developing areas through capacity fees~~ from the reserves in the Expansion Fund category. These reserves are primarily derived from the proceeds of the "incremental" portion of the capacity fees collected within developing areas. This

portion of the ~~Future expansion costs are divided by all future connections to calculate the capacity fee. This capacity fee is the primary funding source for expansion projects and is~~ capacity fees is accounted for separately and used ~~solely~~ for the planning, design, and construction of expansion facilities. Additionally, expansion may be financed by annexation fees or the "buy-in" portion of the capacity fee. Both of these fees are restricted for CIP purposes, but not specifically for expansion. ~~The majority of the funding sources are restricted in nature with the exception of the general use funds placed into the Designated Expansion Fund.~~ Debt financing may also be a temporary financial resource for expansion projects. General use reserves may also be placed in the Designated Expansion Fund and used for expansion projects.

c. Replacement

The portion of a CIP project that benefits existing users by replacing an existing facility is financed from the reserves in the Replacement Fund category. Replacement of facilities may be financed with proceeds of annexation fees, the "buy-in" portion of the capacity fees, general use reserves held in the Desginated Replacement Fund and debt proceeds. The various funding sources available for replacement projects is anticipated to provide the necessary flexibility to begin projects while any necessary debt financing is being obtained.

d~~b~~. Betterment ~~Fund~~

~~The District may construct a project that results in a significant benefit to existing users.~~ Facilities that improve reliability, ~~or~~ meet new regulations, or create increased levels ~~standards~~ of service are considered betterment facilities that benefit existing users. The reserves in the Better Fund category are used to finance these projects or portions of projects. Certain user rates, charges, and betterment fees are restricted geographically for betterment of facilities, but may also be used for general maintenance of facilities in that area. Proceeds of the annexation fee and the "buy-in" portion of the capacity fees may also be used to finance betterment projects. General use reserves may be placed in the Designated Betterment Fund and used for betterment projects. ~~In such a case, user rate charges and betterment fees could be used as a funding source for that portion of the project that results in a lowering of overall operation and maintenance costs or an improvement to the existing users. Betterment may also be a result of increased standards or regulations on water or sewer systems. If the existing system must be improved in order to meet the new standards this cost is a~~

~~betterment cost. The majority of the funding sources are restricted in nature of their use and the geographic area of use, with the exception of the general use funds placed in the Designated Betterment Fund.~~

~~c. Replacement Fund~~

~~Replacement of facilities is funded primarily by general user rates. The portion of a project that benefits existing users is funded by the Replacement Fund. It is expected that the District will debt finance a significant portion of the future replacement facilities. The District has a Debt Policy (Policy No. 45) that guides the debt issuance process. The replacement reserve will serve as an immediate funding source for replacement projects and will provide the necessary flexibility to begin projects while the appropriate debt financing is being obtained.~~

OTAY WATER DISTRICT **BOARD OF DIRECTORS POLICY**			
Subject RESERVE POLICY	Policy Number 25	Date Adopted: 2/10/93	Date Revised ~~3/13/06~~ 11/3/10

1.21 Relocations

Occasionally, relocation of ~~facilities~~ a District facility is required by a third party. ~~when~~ If the District has a superior easement~~s~~ the relocation cost will be paid by the third party, but only to the extent that the District does not benefit from the relocation. ~~for the pipe location. When a project is relocated, the cost of the new facility shall be funded by the party without an easement or if no parties have easements then it is funded by the party causing the relocation. When this occurs,~~ When relocation is required, a CIP project may be created which is wholly or partially ~~funded~~ financed by a third party. ~~who must reimburse the District for the cost of the relocation.~~ On occasion, the District will require that its own facilities be relocated. Depending on the nature of the facilities, the ~~funding~~ financial ~~source~~ resources for these projects could be from new water supply, ~~replacement,~~ expansion, replacement, betterment or third party ~~funding of projects at the District~~financing. Each project is individually negotiated with the third party based on the facts and circumstances of the relocation. Occasionally, the District will improve the facilities that are being relocated. When determining how to allocate costs to various funds ~~much this fund will pay for construction,~~ the following guideline is suggested: if a project has more than five years of useful life remaining, an incremental cost view should be considered; if the project has ~~then funding is incremental, if there is~~ less than five years of useful life remaining, ~~funds are contributed from the Replacement Fund on~~ a pro-rata ~~basis~~cost approach should be considered. Also, the likelihood the District will benefit from an asset's life extension should be evaluated prior to allocating costs.

1.22 Oversizing

~~In some cases, where reasonable, the developer may be required by the District to oversize new facilities for future development in order to obtain economies of scale. The developer will be reimbursed for incremental over-sizing costs as per Policy No. 27. These reimbursements are only for backbone facilities funded by capacity fees - not for the distribution system within a development~~

~~which is an obligation of the developer separate from the capacity fees. These smaller distribution pipes serving the individual homes within a development are often referred to as "in-tract" pipelines.~~ If deemed reasonable by the District, in connection with the construction of backbone facilities, a developer may be required to oversize new facilities for future development. The developer is reimbursed for incremental oversizing costs as per Policy No. 26.

OTAY WATER DISTRICT
BOARD OF DIRECTORS POLICY

Subject	Policy Number	Date Adopted:	Date Revised
RESERVE POLICY	25	2/10/93	~~3/13/06~~ 11/3/10

~~These reimbursements are not available for the distribution system within a development which is an obligation of the developer.~~

1.23 Exclusion of Developed Areas from Expansion Costs
Developed areas are ~~considered~~ assumed to have sufficient supply and capacity to meet their current requirements as provided by the developers. In addition, they are considered to have borne capital financial costs that are at least proportionate to the benefits they have received from capital facilities. Accordingly, no regional capital financi~~al~~ng costs are allocated to these areas so that they will not incur any costs for newly developing areas, ~~. In the case of a~~ except for capital projects that produce~~s~~ ~~D~~district-wide benefit or cost savings~~, however; the District may provide financial support to new facilities~~.

1.24 Improvement Districts (IDs)
Improvement Districts (IDs) are established ~~in order~~ to facilitate the ~~funding~~ financing of ~~a~~ particular improvements by the specific beneficiaries. The District has a number of ~~I~~improvement ~~D~~districts that were established for General Obligation (GO) debt repayment. ~~Many of these~~ Most GO ~~issuances~~ debt ~~have~~ has been paid off and~~, as outlined in the Debt Policy,~~ it is unlikely that the District will issue additional GO debt. ~~IDs~~ Improvement districts continue to be used for other ~~funding~~ purposes~~.~~: ~~First,~~ 1) to distinguish sewer customers from water customers on the county tax roll; ~~second,~~ 2) to place parcels on the county tax roll for the collection of availability fees; or ~~third,~~ 3) for ~~the~~ charging ~~of~~ special water rates~~; and fourth, to track which properties have paid annexation fees~~.

Over the years, the District ~~has taken a~~ moved to a district-wide perspective ~~to~~ of ~~funding~~ financing improvements. This philosophy is evident by the district-wide capacity ~~fee~~ and annexation fees. The District also uses district-wide water rates. As time ~~continues~~ goes on, it is expected that IDs will continue to outgrow their purpose~~.~~ ~~So, while many IDs remain~~ and their use will diminish ~~over time~~.

1.3 The Purpose of the Policy

Public entities accumulate and maintain reserves to ensure both financial stability and ~~the continuation of the ability to provide~~ continuous availability of services. Financial stability and the ~~increase in~~ resulting improved credit quality ~~that result from stability~~ allow the public entity to weather times of uncertainty and the impacts~~s~~ of negative events, both major and minor. ~~Funded r~~Reserves allow for the ~~continued~~ ongoing maintenance of property and timely payment of expenses ~~beyond the magnitude of the funds~~ even when such expenses exceed money available ~~in~~ from a single fiscal period. In the final analysis, the type and level of reserves are driven by the type and magnitude of uncertainty faced by the ~~District~~public entity.

A "reserve" has a number of meanings, as follows:

- Working capital is required to insure timely payment of obligations.
- A buffer against volatility in revenues.
- Liquidity is required to obtain other goods and services (*e.g.*, bank services).
- Designated ~~funds~~ money to protect creditors.
- ~~Funds~~ Money set aside to replace assets at the end of their useful lives.
- ~~Funds~~ Money set aside to repair or replace assets damaged or destroyed at unanticipated times.

It is important to note that reserves, fund balance, and net assets are not the same. Fund balance and net assets are accounting terms and may not always be in the form of cash or liquid investments. Fund balances and net assets may not always be reserves unless a designation of all or a portion of fund balance is made. ~~It is important to note that~~ In addition, the term~~,~~ fund balance was ~~recently~~ replaced by net assets as codified by the Governmental Accounting Standards Board (GASB).

In short, reserves are the liquid assets of the District, accumulated and maintained for application to ~~fund~~ finance contingent future activities, whether known or unanticipated, operating or capital in nature. The District's Reserve Policy governs the management and use of these ~~funds~~financial resources. Few policies have a more significant impact on the financial health and stability of the District. This policy explains several key financial concepts used by the District and provides some background information to the overall strategies and practices utilized. The District has a fiduciary obligation to its customers, to manage and direct the use of public funds for the purpose of providing water and sewer services in an efficient and financially sound manner.

1.4 Policy Guidelines

In 2000, the Little Hoover Commission reviewed the levels of reserve funds for special districts in California and prepared a report reflecting that special districts were accumulating unreasonable levels of funds. As a proactive response, the California Special Districts Association (CSDA) prepared Reserve Guidelines for its members. The Reserve Guidelines were significant in noting that reserve levels need to be in context of the organization's overall business model and capital improvement plan.

There are a number of potential events which the District should consider in the development of reserves:

- Economic Uncertainty - performance of the regional economy and the impact of that performance on demand for water.
- Weather - the amount of rainfall and the impact of weather on the availability and the cost of water as well as the demand for water.
- Government Mandates - the impact of federal and state regulation, particularly environmental regulation.
- Tax Changes - limitations on the District's taxing and spending powers through the passage of a voter referendum, the impound of District property taxes or the removal of the District's power to levy property taxes, further increases to Educational Revenue Augmentation Fund (ERAF) contributions or changes in calculation methodology.
- Operating Costs - increases in operating and maintenance costs because of inflation, labor agreement or other modification.
- Force Majeure - unanticipated expenditures resulting from natural disasters or intentional acts.
- Emergency Maintenance - unanticipated expenditures resulting from unexpected failure of assets (*e.g.*, rupture in the primary transmission system).
- Unexpected Variation in Cash Flow - the incidence of additional costs or decreased revenues that require~~s~~ short-term borrowing in the absence of sufficient ~~funds~~financial resources.

The California State Auditor has, in its oversight role, offered a number of quality recommendations for the development of reserve policies as outlined in its report entitled, "California's Independent Water Districts: Reserve Amounts Are Not Always Sufficiently Justified, and Some Expenses and Contract Decisions Are Questionable," dated June 2004, Report No. 2003-137. ~~Each~~ All of these recommendations ha~~s~~ve been incorporated into this policy in an effort to address key issues surrounding the management and use of District reserves. The detailed objectives as identified by the State Auditor are as follows:

- Distinguish between restricted and unrestricted reserves.
- Establish distinct purposes for all reserves.
- Set target levels, ~~such as~~ including minimums and maximums, for the accumulation of reserves.
- Identify the events or conditions that prompt the use of reserves.
- Conform ~~with~~ to plans to acquire or build capital assets.
- Receive Board approval and that it is in writing.
- Require periodic review of reserve balances and rationale for maintaining them.

Yet, the State Auditor's report acknowledges that the California Constitution (Article XIII B, Section 5) is vague in its provisions governing the accumulation and use of reserves[1]. Specifically, the Constitution states that "each entity of the government can establish contingency, emergency, unemployment, reserve, sinking fund…or similar funds as it shall deem~~s~~ reasonable and proper.[2]" Similarly, the State's Water Code does not impose any requirements as to specific or recommended reserve fund levels. As a result, the public finance community as a whole has yet to settle on any real objective standards for the level of reserve funds appropriate for governmental enterprises. This lack of consensus as to specific standards is indicative of the wide variance of the financial and operations context~~s~~ for different districts and different contingencies justifying reserves ~~of funds~~.

The Government Finance Officers Association (GFOA) in its "Recommended Practice on Appropriate Level of Unreserved Fund Balance in the General Fund" (2002) states~~:~~ that ~~I~~in establishing a policy governing the level of unreserved fund balance in the general fund, a government should consider a variety of factors~~,~~. These includ~~ing~~e:

- The predictability of its revenues and the volatility of its expenditures (*i.e.*, higher levels of the unreserved fund balances may be needed if significant revenue sources are subject to unpredictable fluctuations or if operating expenditures are highly volatile).

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[1] California State Auditor, Bureau of State Audits, "California's Independent Water Districts: Reserve Amounts Are Not Always Sufficiently Justified, and Some Expenses and Contract Decisions Are Questionable," dated June 2004, 2003-137; p. 8.

[2] California Constitution, Article XIII B, Section 5. ~~State Auditor, Bureau of State Audits, "California's Independent Water Districts: Reserve Amounts Are Not Always Sufficiently Justified, and Some Expenses and Contract Decisions Are Questionable," dated June 2004, 2003-137; p. 8.~~

- The availability of resources in other funds as well as the potential drain upon general fund resources from other funds (*i.e.*, the availability of resources in other funds may reduce the amount of the unreserved fund balance needed in the general fund, just as deficits in other funds may require that a higher level of unreserved fund balance be maintained in the general fund).
- Liquidity (*i.e.*, a disparity between when financial resources actually become available to make payments and the average maturity of related liabilities may require that a higher level of resources be maintained).
- Designations (*i.e.*, governments may wish to maintain higher levels of unreserved fund balance to compensate for any portion of unreserved fund balance already designated for a specific purpose).

In the preparation of this policy, each of the CSDA guidelines and the GFOA recommendations has been considered. In addition, all seven objectives provided by the State Auditor are specifically addressed for each reserve. The District wholly supports the State Auditor's efforts to bring a high-level of quality to reserve governance and establishing a standard of performance.

The District recognizes that the customer pays for services provided. Quality management requires that periodic valuations be performed so that fees and charges can be set at appropriate levels to recover the cost of service. The District's Reserve Policy has been drafted with consideration of the GFOA, CSDA, and State Auditor general guidelines as provided above. In addition, the District has adopted the following principles in the management of its ~~funds~~ financial resources:

- ~~Funds~~ Reserves are held and used only for the purpose for which they are collected. This is done to maintain equity ~~between~~ among customers.
- Each of the service types is tracked separately so that expenditures and revenues can be monitored and evaluated for each customer type. This provides the District with the necessary information to appropriately charge for each of the services.
- Separation of ~~O&M~~ operations and maintenance from capital expenditures occurs within each of the service types. This is done because the ~~funding~~ financing of these expenditures is often on different timelines or use different ~~funding sources~~reserves.
- The District will hold its reserve at responsible and prudent levels. This policy sets minimum, maximum, and target levels for

each of the various funds. This has been done so that the District can maintain ~~funds~~ reserves to meet the purpose for which the funds were established. The levels are set by reference to line items in the District's financial statements and approved budgets. This allows reserve levels to adjust to the District's changing financial circumstances.

- Debt financing of facilities provides intergenerational equity and maintains rates at reasonable levels. This equity is accomplished with ~~the~~ long-term financing ~~by~~ which spread~~ings~~s the cost of facilities over the life of the facilities. The burden to pay for facilities is then paid by those who use them. ~~Optionally, t~~The District could amass significant reserves by pre-collecting ~~funds~~ financial resources in a Replacement Reserve Fund allowing the District to cash ~~fund~~ finance all replacements. ~~In order to obtain those funds,~~ However, this would require significant rate increases, ~~would be required,~~ burdening the current customers and creating reserve levels difficult to defend to the ratepayers or other oversight entities.

These concepts are fundamental to the way the District manages its funds and have a direct impact on the way rates and charges are set. The District performs annual budget evaluations and updates its rate ~~study~~ model on ~~at least~~ an annual basis to monitor and adjust the various funds and revenue sources. The separation, tracking, and projecting of the various funds and expenditures create the essential information necessary for the equitable rate structure maintained by the District. The annual review preserves the balance between services provided and the ~~prices~~ fees charged. This review also insures that ~~funds~~ reserves will be available to continue to serve the District's customers.

~~**SOURCES OF FUNDS**~~

Financial Sources

2.0 Developers

a. ~~a.~~ Meter Installation Charges (General Use)
Meter fees are charges collected for new water service connections. Fees vary depending upon meter size and type of service. The costs associated with meter installations are included in the Operating Expenses section of the budget. These charges are ~~funded~~ financed by developers.

b. ~~c~~. Developer Deposits (General Use)
These deposits are for the engineering and operations services provided to developers. They are tracked separately for each developer and any excess amount is returned to the developer.

c. ~~b.~~ Annexation Fees (~~General Use~~Restricted)
Annexation ~~F~~fees[3] are collected as a condition of annexing into ~~are outlined in Section 9 of the Code of Ordinances. This is the buy-in to~~ the District's potable and recycled water facilities. Since the existing facilities have been built and maintained by developers or customers within the District, the annexation fee is calculated based on the present value of all property taxes (1% property tax and availability fees) ~~-~~paid by ~~the developer and based on the excess capacity built by~~ existing and prior customers.~~users.~~ ~~This~~ The annexation fee insures that future users ~~fund~~ finance a portion of ~~the~~ facilities that were sized, ~~and~~ built, and maintained for ~~their~~ both existing and future users. ~~by prior customers. The annexation fees are general use funds and help to offset current customer costs. The calculation of the fee uses a system-wide evaluation that combines the potable and reclamation systems. This methodology is used because the two water systems work hand-in-hand, the recycled system brings a new supply of water to the District reducing the need for potable systems and the higher cost of obtaining new potable supplies.~~ Proceeds of annexation fees are restricted and can be used for expansion, replacement, or betterment projects. These reserves may be shifted back and forth as financing needs change.

d. Annexation Fees (Unrestricted)
A sewer annexation fee is collected when a property is annexed into an improvement district. This fee is calculated using the "buy-in" basis and therefore is unrestricted.

e. New Water Supply Fee (Restricted)
New water supply fees[4] are based on the cost of the expansion portion of new water supply projects divided by the number of future equivalent dwelling units (EDU). The new water supply fee covers the cost of planning, design, construction, and financing associated with facilities for the District's new supply needs. These fees are paid by developers. The proceeds of this fee may be used only for new potable or recycled water supply projects.

[3] Code of Ordinances, Section 9.
[4] Code of Ordinances, Section 28

Although the fees collected are not restricted separately, one portion for potable and the other for recycled, they are tracked separately.

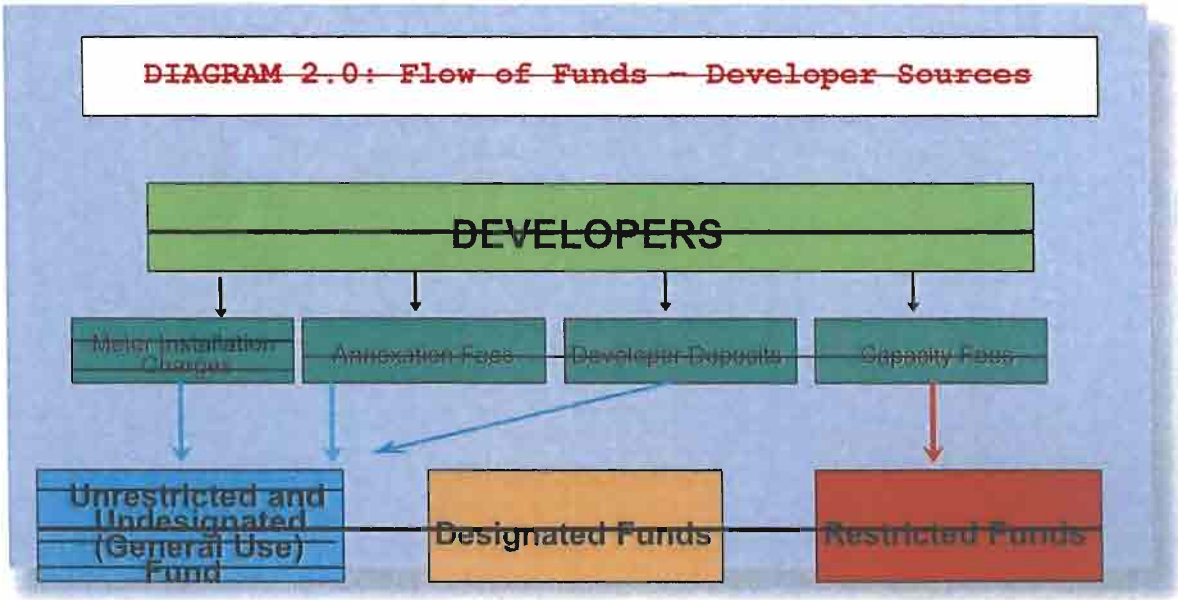
~~d.~~ Capacity Fees (Restricted)
~~The capacity fee is outlined in Section 28 of the Code of Ordinances.~~ Capacity fees[4] are based on the value of existing and future facilities ~~estimated construction cost of expansion~~ divided by the number of existing and future ~~E~~equivalent ~~D~~dwelling ~~U~~units. This method of calculating capacity fees is called the combined method, where the "buy-in" portion of ~~T~~the capacity fee covers costs to repay existing customers for the facilities that they have built, and where the "incremental" portion of the capacity fee covers the cost of future expansion facilities. The "buy-in" portion of the capacity fee is restricted to pay for ~~including, but not limited to,~~ planning, design, construction, and financing associated with expansion, replacement or betterment facilities. The "buy-in" portion may be shifted back and forth between expansion, betterment or replacement as the financing needs change. ~~for the District's expansion needs.~~ The "incremental" portion of the capacity fee is limited to planning, design, construction, and financing exclusively for expansion facilities (excluding new water supply expansion).

~~Ultimate f~~Facility needs are based on projected land use planning. Changes in anticipated future land use occur and can alter projected facility requirements. Thus, both the anticipated facilities ~~These~~ needs and ~~the~~ their projected costs change over time as regulatory agencies make changes to ~~determining~~ land use ~~make changes~~. ~~Significant variations in future land use occur and can alter projected facility requirements. As these changes occur, t~~The District periodically ~~will~~ reviews the capacity fee calculation to accommodate such variations. These fees are paid by developers.

The District's construction of infrastructure occurs prior to the addition of EDUs. This sequence serves two purposes: one it ensures that the District can serve the pending construction as it is completed; and two, it is more efficient to oversize many facilities at the outset rather than build for the current need and then reconstruct when the future need is realized. As a result of this strategy, the District has financed construction with bond financing as the existing expansion ~~funds~~ reserves are depleted.

The capacity fee is calculated based on the ~~expansion costs of the~~ combined recycled and potable water systems needs. This methodology,

~~just like the annexation fee methodology,~~ is used because the two water systems work hand-in-hand. All capacity fees can be used for either potable or recycled but must be tracked to distinguish between the "buy-in" and "incremental" portions as described above. ~~only for expansion needs.~~ So, while capacity fees are not restricted separately~~,~~ ~~one portion for~~ by potable and ~~the other portion for~~ recycled, they are tracked separately.

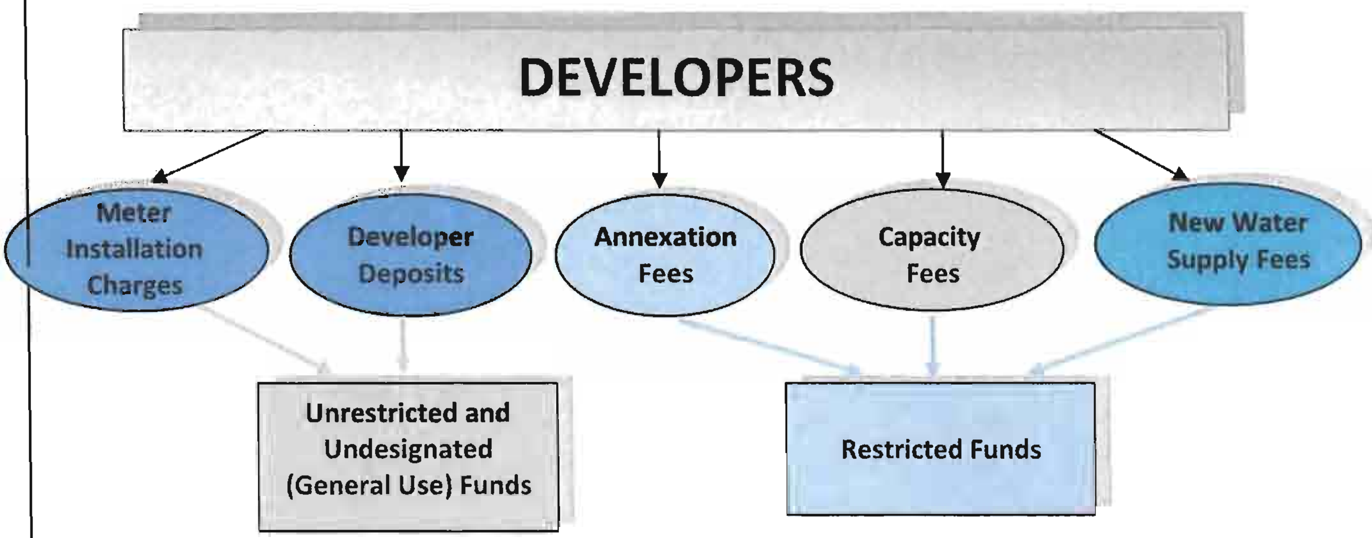


~~DIAGRAM 2.0: Flow of Funds – Developer Sources~~
~~DEVELOPERS~~
~~Meter Installation Charges~~
~~Annexation Fees~~
~~Developer Deposits~~
~~Capacity Fees~~
~~Unrestricted and Undesignated (General Use) Fund~~
~~Designated Funds~~
~~Restricted Funds~~

OTAY WATER DISTRICT
BOARD OF DIRECTORS POLICY

Subject	Policy Number	Date Adopted	Date Revised
RESERVE POLICY	25	2/10/93	~~3/13/06~~ 11/3/10

Diagram 2.0: Flow of Funds – Developer Sources



2.1 Customers/Users

a. Uniform Rates and Charges (General Use)
Charges to users for water, sewer, and recycled water are uniform throughout the District for similar customer types. ~~This policy reduces possible misunderstanding that might occur among customers if rates varied between geographical areas. It also provides for an administratively straightforward billing process.~~

b. Monthly System Fees (General Use)
This is a fixed revenue source that is charged monthly. The amount of the charge is based on the meter size.

c. Energy Charges (General Use)
The energy pumping fee is ~~$0.032~~ a charge per unit of water for each 100 feet of lift, or fraction thereof, above the base elevation of 450 feet. This charge is placed on the monthly water bills of all water customers.

d. Penalties (General Use)

Penalties are added to the monthly water and sewer bills for late charges, locks, etc.

e. Pass-through Fixed Charges (General Use)
A fixed monthly charge to the District's customers intended to collect sufficient funds to pass-through the increased fixed costs from the County Water Authority (CWA) ~~-~~and the Metropolitan Water District (MWD).

f. Special Rates and Charges (Restricted)
In addition to the uniform water charges, the District currently has five special water rates and one sewer rate. The five water rates are ~~all~~ for construction, installation, and maintenance of water storage reservoirs, pump stations, and water lines ~~in the respective areas~~. Each of these rates and charges must be used within the respective areas ~~is listed as follows:~~ from which they are collected. These special charges are listed below:

- North District water charge (~~c~~Code section 25.03~~H~~G)
- ID 9 water charge (~~c~~Code section 25.03~~I~~H)
- ID 3 water charge (~~c~~Code section 25.03I~~J~~)
- ID 10 water charge (~~c~~Code section 25.03~~J~~I)
- La Presa water charge (~~c~~Code section 25.03~~J~~I)
- Russell Square sewer charge (~~c~~Code section 53.04C)

When these rates were established they were for the specific purpose of constructing, installing, and maintaining the water and sewer systems in the areas in which the fees ~~that they~~ were collected. Therefore, these are ~~R~~restricted ~~Funds~~ reserves by geographic area as well as by purpose. These ~~fees however,~~ rates and charges can also be used for maintenance~~,~~; unlike the availability fees (discussed in 2.2 B.). These six special ~~fees~~ rates and charges along with availability fees are tracked separately, by geographic area, so they can be separately evaluated ~~for~~ to maintain the targeted ~~funding~~ reserve levels ~~separately~~. To meet this need, each special rate and charge is accounted for in a "sub-fund" of the ~~b~~Betterment ~~f~~Fund.

g. Temporary Meter Fees (General Use/Restricted)
Water charges, in lieu of capacity fees, are charged on temporary meters. This is done because while temporary meters use system capacity they are not charged a capacity fee. Temporary water use is charged at two times the water rate with the added charge placed in the Restricted Expansion Fund. The primary users of

these temporary meters are developers; however, general customers also use these for various purposes.

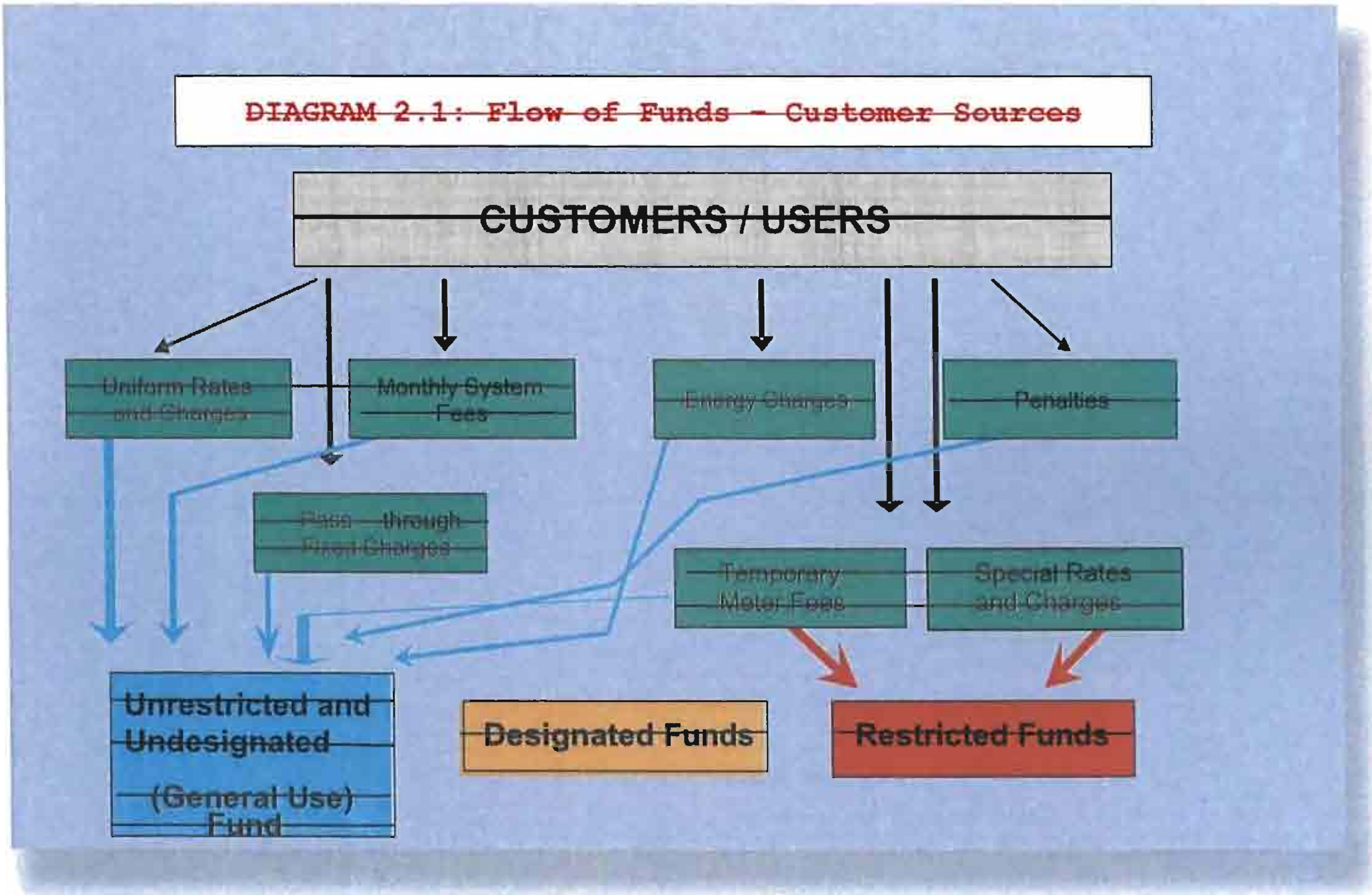
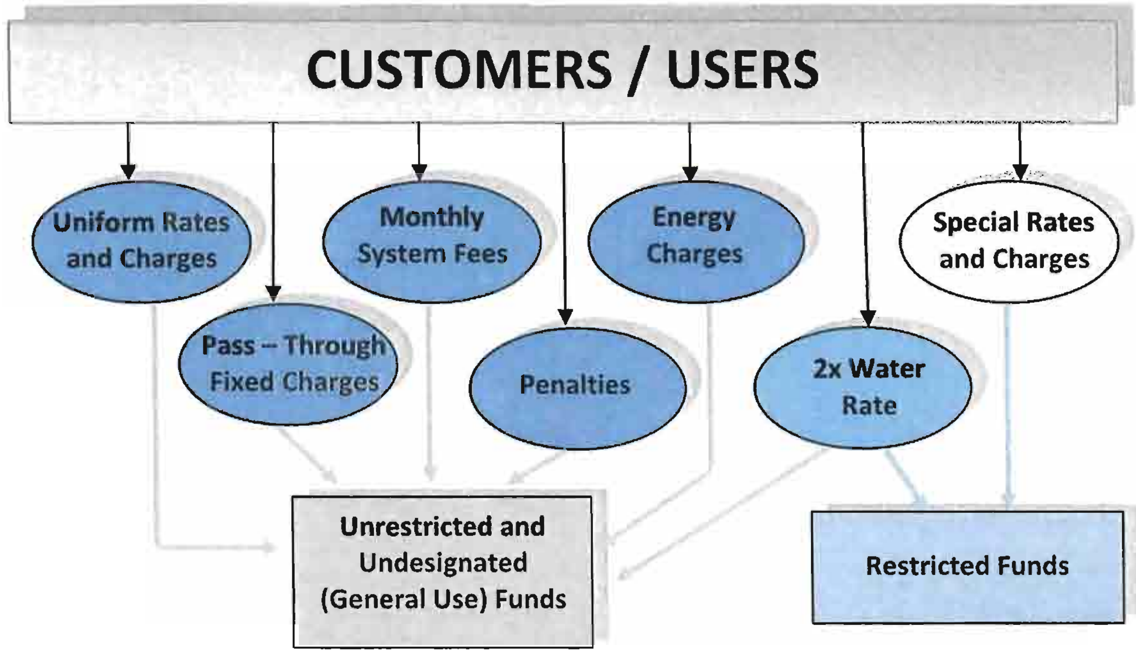


Diagram 2.1: Flow of Funds – Customer Sources



2.2 County-Collected Taxes and Fees

~~a.~~ General Levy Property Tax Receipts (1% Property Tax) (General
a. Use)

In 1978, Proposition 13 limited ~~general~~ the levy of ad valorem property taxes on real property ~~rates for all taxing authorities~~ to ~~a total rate of~~ one percent of the assessed value of such property. Subsequent legislation, AB 8, established that the receipts from the one percent levy were to be distributed to taxing agencies proportionate to each agency's general levy receipts prior to Proposition 13. ~~Funds~~ Taxes received are for general use.

b. Availability Charges (General Use/Restricted)

The District levies availability charges each year in developed and undeveloped areas. Current legislation provides that any amount up to $10 per parcel is general use and any amount over $10 per parcel is restricted to be expended in and for ~~that~~ the ~~I~~improvement ~~D~~district (ID) within which it is collected. ~~IDs were formed to provide the lowest cost funding possible for the development of water and sewer systems.~~ Accordingly, the District may use availability charges in excess of ~~any amount over~~ $10 toward costs of ~~to develop~~ water and sewer ~~systems~~ facilities which are either, expansion, betterment, or replacement of facilities consistent with the purpose of the ID in which they are collected. ~~.~~ This portion of the proceeds of availability charges is geographically restricted and restricted by purpose. As costs are incurred on these projects the respective IDs are charged, reducing the reserves. To the extent that availability charges are not used for the purpose for which they are collected, they must be returned to the property owners that paid them. The District has historically used these reserves for betterment capital facilities thus, ~~T~~the ~~R~~restricted ~~Funds~~ reserves are accounted for in "sub-funds" of the Betterment Fund (see 2.1 f.).

c. ~~Availability fees can be used for the development of facilities consistent with the purpose of the ID which they are collected in, while special rates and fees can also cover the maintenance of those facilities. As charges are incurred on these projects the respective IDs are charged reducing the betterment fund. In the event that funds are not used, the Restricted Funds must be returned to the property owners that paid them. Therefore, the monies in this fund may only be used to finance the construction, installation, and maintenance of the systems within the geographic area of the specific IDs. The District has historically used these funds for betterment capital facilities however, they are available for any facility construction purpose benefiting the ID whether replacement, betterment, or expansion.~~

~~Each year the District sends notices to all new customers informing them of the availability fees and their purpose. This notice also informs the customers of the date and time of the public hearing to receive public comment on this fee. The availability fees are split between the Betterment Fund and the General Fund.~~

~~c.~~ State Loan Assessment (Restricted)
The District assesses a ~~$54~~ charge per unit of sewer service each year on the sewer customers. This is collected via the ~~C~~county ~~T~~tax ~~R~~roll and is specifically collected for the repayment of the State Loan. When this loan is paid off the charge will be removed.

d. Improvement District General Obligation (GO) Bond Assessments (Restricted)
The District has historically ~~occasionally~~ issue~~s~~d ~~GO~~ general obligation debt and establishes an ~~I~~improvement ~~D~~district for the repayment of that debt. When this financing method is used, the ~~C~~county ~~T~~tax ~~R~~roll can be used to collect ~~funds~~ special taxes or assessments within the ID ~~and~~ to pay the debt obligation. The proceeds of the debt are restricted for the purpose as defined in the bond documents.

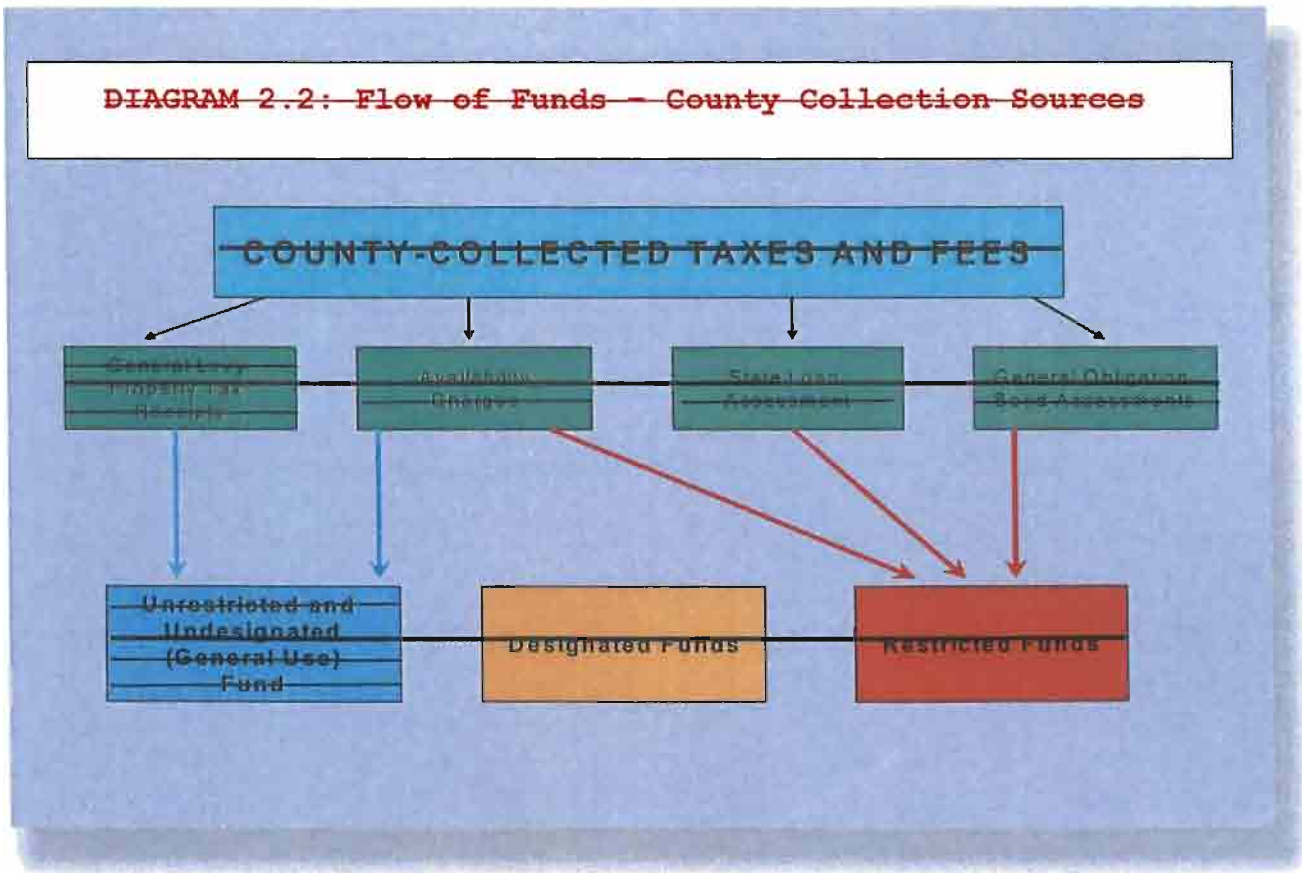
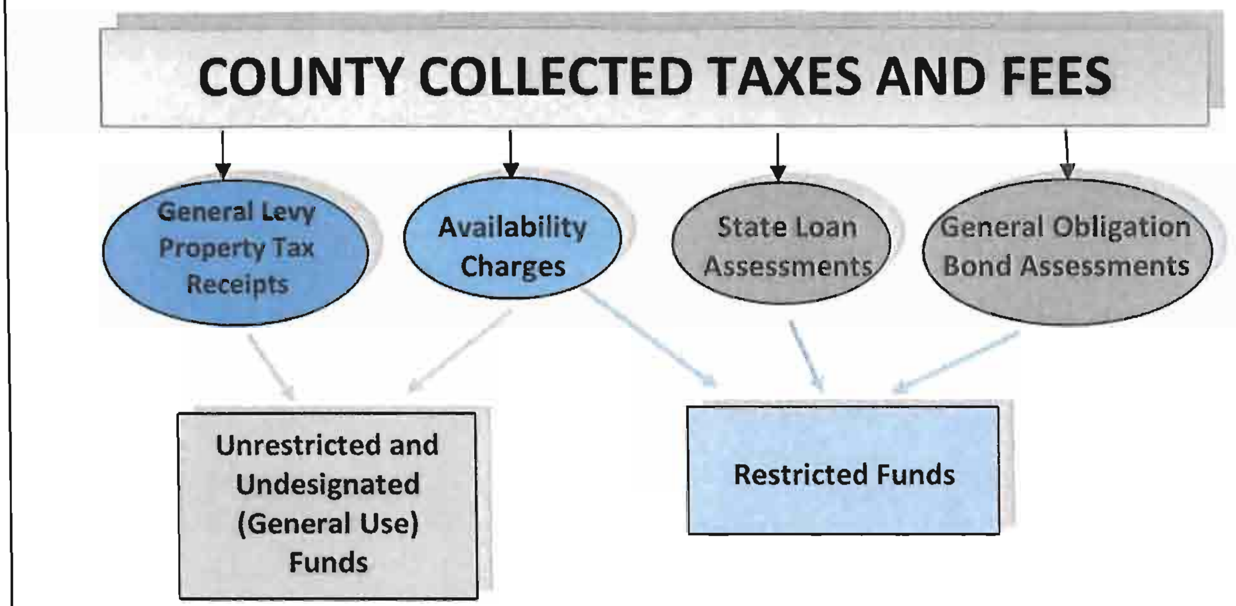


Diagram 2.2: Flow of Funds – County Collection Sources



2.3 Miscellaneous Income

a. Miscellaneous Rents and Leases (General Use)
Revenues received from the rental and lease of District property are general use revenues. Not only are they periodic revenues, but ~~T~~there is also a one-time fee charged with the setup of each new lease. The District incurs expenses related to these rents and leases. The one-time fees are calculated ~~and this fee's purpose is~~ to recover the costs to set-up the leases.

b. Sewer Billing Fees (General Use)
Sewer billing fees are general use revenues. The District provides ~~Fees received from the City of Chula Vista for~~ processing and billing services to the City of Chula Vista to bill and collect from ~~of~~ their ~~sewer~~ customers for sewer service~~within our District~~. These fees are to recover the cost the District incurs to provide this service.

c. Interest Income or Expense Allocation (General Use, Designated, and Restricted)

Interest income (expense) will be allocated ~~each~~ every month based upon each fund's month-ending balance. In this way, each fund receives credit for interest earned by that fund and each fund with a negative balance is charged for the use of the other fund's reserves.

~~**DIAGRAM 2.3: Flow of Funds – Miscellaneous Income Sources**~~

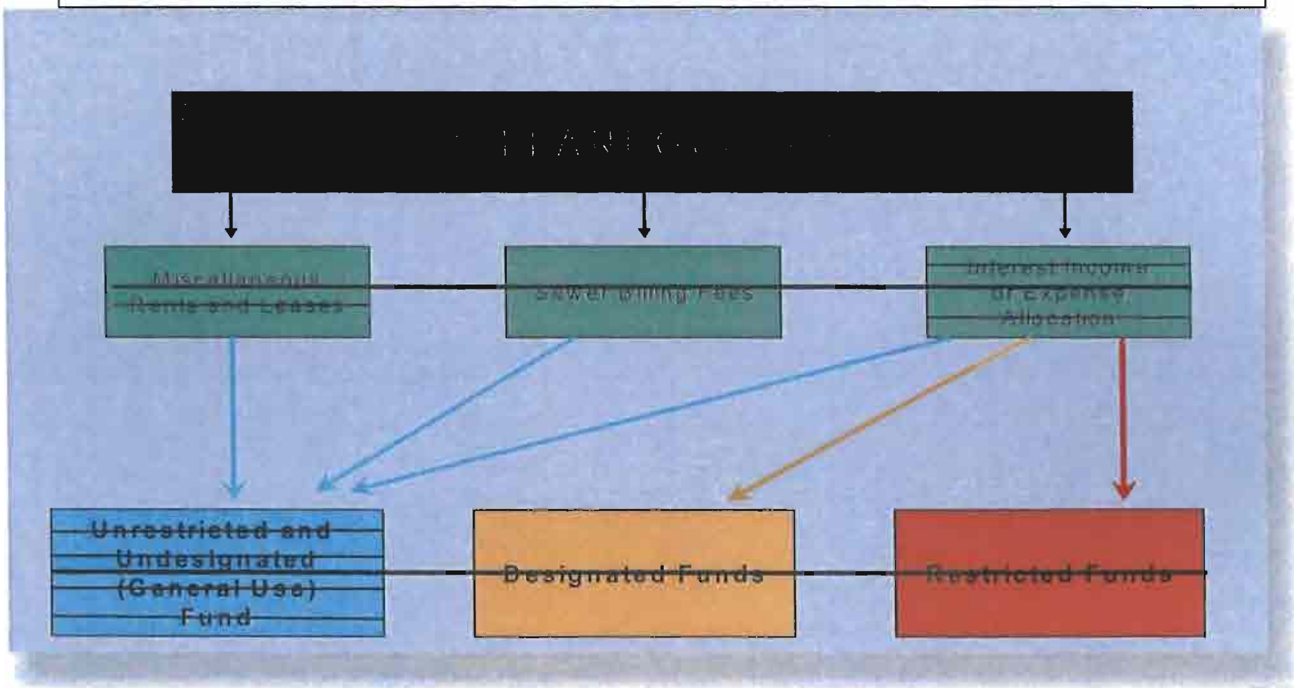
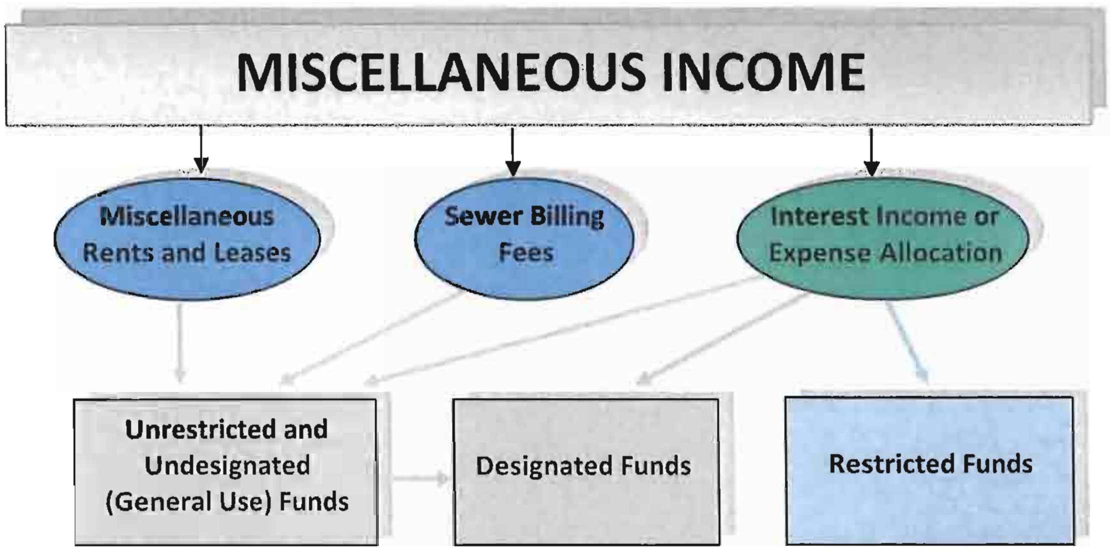


Diagram 2.3: Flow of Funds – Miscellaneous Income Sources



2.4 Debt Issuance

a. Loans (General/Restricted Use)

As the District determines that additional ~~funding~~ financing is required for a particular purpose, the option of borrowing is considered. The determination to borrow is made as a part of the annual rate model update and is evaluated in accordance with the Debt Policy before it is recommended to the Board for action. As an option to bond indebtedness, loans are available especially to satisfy short-term financing needs. These loans may or may not be contractually restricted for a particular purpose.

b. General Obligation (GO) Bonds (Restricted)

As the District becomes more developed it becomes less likely that ~~GO~~ general obligation debt will be used as it requires a vote of the public to be approved. Bond proceeds are restricted for the construction of those facilities identified in the GO bond issuance. Occasionally, specific portions of bond proceeds may be allocated for the repayment of the principal and interest, also called debt service, on these bonds. As the District determines that additional ~~funding~~ financing is required for a particular purpose, the option of debt issuance is considered. The determination to issue debt is made as a part of the annual rate model update and is evaluated in accordance with the Debt Policy before it is recommended to the Board for action.

c. Certificates of Participation (COPs) (Restricted)
General revenues of the District are pledged as security for ~~COPs~~ Certificates of Participation (COPs) indebtedness. ~~Before issuing COPs,~~ If the District ~~will~~ determines that additional ~~funding~~ financing is required for a particular purpose, the option of debt issuance is considered. The determination to issue debt is made as a part of the annual rate ~~study~~ model update and is evaluated in accordance with the Debt Policy before it is recommended to the Board for action. This form of financing has become the industry's preferred form of financing as it does not require a vote of the general public.

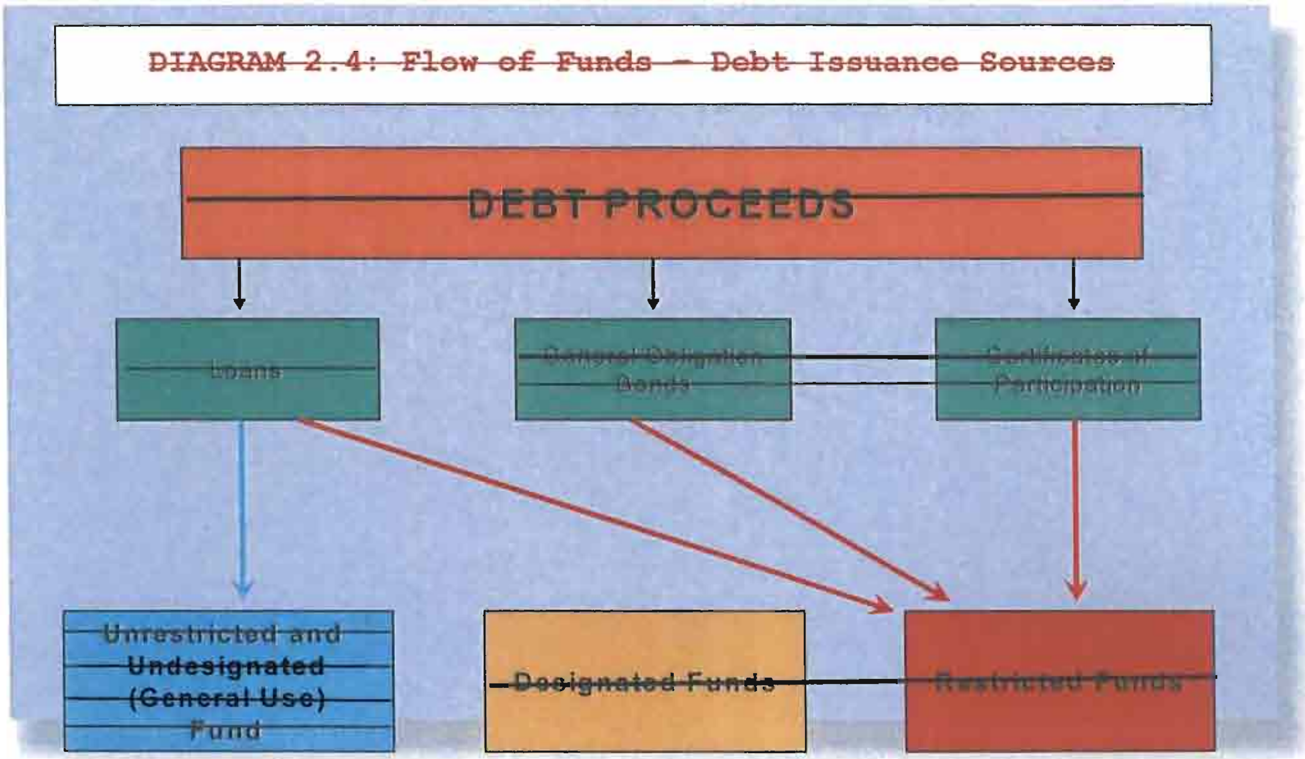
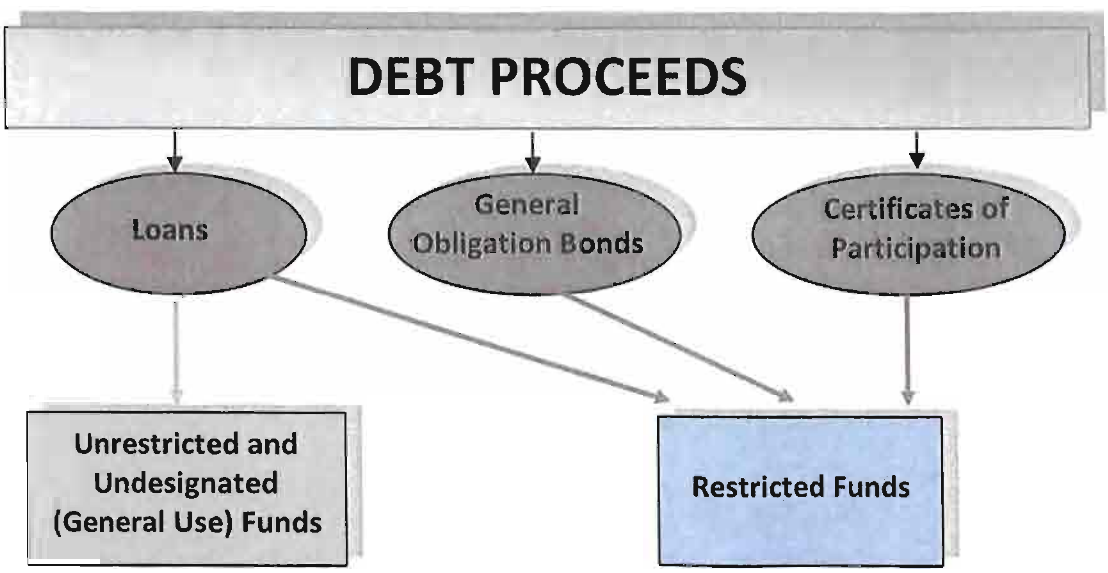


Diagram 2.4: Flow of Funds – Debt Issuance Sources



2.5 Inter-fund Transfers

Each year in the budgeting process, future ~~reserve~~ fund levels are projected ~~over~~ for the next six years. Based on these projections~~,~~ ~~fund~~ transfers are recommended. ~~Monies~~ Reserves may be transferred between Unrestricted or Designated Funds and the General Fund (see 4.0 "Funding Levels" and 4.1 "Fund Transfers"). ~~Funds~~ Reserves may not be transferred to or from any of the restricted funds unless it is between two restricted funds with a shared purpose.

~~**FUND TYPES**~~
Fund Types and Categories

3.0 General Funds

a. Purpose

The General Fund is neither restricted nor designated. The District maintains ~~only~~ one General Fund for each business segment (water, sewer, and recycled). This fund holds the working capital and emergency operating reserves. While the General Fund has a short-term focus to finance the District's annual operations, it is supported by the six-year rate model. This fund is primarily used to finance the operations of the District; however, it can be used for any District purpose.

This fund can be used to supplement the District's rates and charges and be a temporary source of revenue to balance the Operating Budget. This fund can also be used to ~~and~~ avoid spikes in the rates or significant and abrupt increases. It is an industry practice to have a fund that can be used to stabilize rates. This would only occur if there was a temporary need for ~~funds~~ reserves that would smooth out a rate spike or to ramp up what would otherwise be a dramatic rate increase.

~~This~~ The General ~~f~~Fund also plays a role in the debt planning of the District. ~~It is an industry practice to have a fund that can be used to stabilize rates.~~ This fund is viewed by the debt markets as a commitment by the District to ensure financial stability of the rates and charges of the District. The District is anticipated to ~~issue~~ need a number of debt issuances over the years and this fund will help the District not only to stabilize rate fluctuations but also to access low cost financing for future projects.

~~While the General Fund has a short-term focus to fund the District's annual operations, it is supported by the six year rate model. This fund is primarily used to fund the operations of the District however; it can be used for any District purpose.~~

b. Sources

The potable and recycled general funds receive ~~M~~meter installation charges, ~~annexation fees,~~ temporary meter fees, uniform rates and charges, monthly system fees, energy charges, penalties, pass-through fixed charges, general levy property tax receipts, availability charges, miscellaneous rents and leases, sewer billing fees, interest income~~s~~ or expense allocation, loans, and a portion of the temporary ~~meter fees~~ water sales.

The sewer general fund receives sewer charges, penalties, availability charges, sewer annexation fees (calculated on the "buy-in" basis), and interest income or expense allocation.

~~a.~~c. Funding Levels

~~i~~I. **Minimum Level** - The minimum ~~funding~~ reserve level for each business segment of the General Fund is three months of operating budget expenses (evaluated separately for each segment).

~~ii~~II. **Maximum Level** - The maximum ~~funding~~ reserve level for the General Fund is nine months of operating budget expenses. In the event that this fund exceeds the seven month level, the excess will be evaluated or transferred to one or more of the designated funds.

~~iii~~III. **Target Level** - The target level of ~~funding~~ reserves is three months of operating budget expenses. In the event that the fund drops below the target level, rate increases or fund transfers would be considered.

OTAY WATER DISTRICT **BOARD OF DIRECTORS POLICY**			
Subject RESERVE POLICY	Policy Number 25	Date Adopted 2/10/93	Date Revised ~~3/13/06~~ 11/3/10

~~3.1 Designated Funds~~

~~a. Purpose~~
~~Designated cash funds are "general use" funds that have been set apart by Board action for a specific purpose. These funds can only be used for those purposes. However, these funds are at the discretion of the Board and can be used for any District purpose by an action of the Board. The District maintains designated cash funds as follows:~~

- ~~Other Post Employment Benefits Fund (OPEB)~~
- ~~Designated Expansion Fund~~
- ~~Designated Betterment Fund~~
- ~~Replacement Fund~~

~~Detailed descriptions of the funds are as follows:~~

3.1 Designated Other Post Employment Benefits Fund (OPEB)

Designated Other Post Employee Benefits ~~The~~ (OPEB) ~~Fund~~ reserves are "general use" reserves that have been set apart by Board action ~~is used~~ to ~~fund~~ finance the medical benefits of qualified retirees as outlined in the District's benefits plan. This District fund holds only a portion of the total OPEB reserves. The other portion is held in a trust at CalPERS and is restricted for the purpose of financing the OPEB liability. The two portions are considered jointly when looking at target reserve levels. ~~It is fully funded by user rates.~~ Every two years the fund is evaluated by an actuary to update ~~for additional funding~~ the annual financing requirements. Changes in the actuarial valuation may result from changes in benefit levels, employee population, ~~costs of~~ health insurance costs, or general market conditions.

These ~~funds~~ reserves held by the District are currently designated ~~but~~ and may be placed into ~~a trust~~ the CalPERS trust to legally restrict the funds, ~~effectively~~ removing the District's ~~day-to-day~~ legal access to ~~the funds~~these reserves. ~~This would allow the funds to offset the actuarial liability of the District to fund OPEB. However, these funds are currently designated and therefore, may be used at Board direction for any purpose.~~

a. Sources

The OPEB liability may be financed by general use reserves coming from user rates and charges, either from an operating budget expenditure or from interfund transfers. Transfers of unrestricted reserves may come from the various designated funds or from the General Fund. As a part of the normal budget process, annual operating revenues have been sufficient to finance the ongoing needs of this designated fund. While debt financing is also an option, the District has only used user rates and charges to finance this fund.

b. Funding Levels ~~Other Post Employment Benefits Fund~~

~~A. **Minimum Level** - Fully funded as identified under the actuarial study of the District's OPEB liability.~~

~~B. **Maximum Level** - Fully funded as identified by an actuarial study. In the event that the fund is over funded, the District will target for the full funding within five (5) years reducing the annual funding levels.~~

~~C. **Target Level** - Fully funded to meet the actuarially defined valuation. In the event that the fund is not fully funded, the District will target for full funding within five (5) years by increasing funding levels. This increased funding would be in the form of either annual budget funding or fund transfers.~~

I. **Minimum Level** - The minimum reserve level for this fund is equal to the District's OPEB liability as determined by the actuarial study. When considering the reserve level of this fund, both the District held OPEB reserves and CalPERS held OPEB reserves must be considered jointly.

II. **Maximum Level** - The maximum reserve level for this fund is equal to the District's OPEB liability as determined by the actuarial study. In the event that the two funds, as described above, exceed the OPEB liability, the District will reduce the annual funding levels as defined by the actuarial study.

III. **Target Level** - The target reserve level for this fund is equal to the District's OPEB liability as determined by the actuarial study. In the event that the two funds, as described above, fall below the OPEB liability, the District will increase the annual funding levels as defined by the actuarial study.

3.2 New Water Supply Fund Category

a. Purpose
The New Water Supply Fund category is to finance the expansion portion of new water supply projects and is therefore to be paid for by developers. When considering the reserve level of the New Water Supply Fund, the New Water Supply Debt Fund, and the Designated New Water Supply Fund work in concert and must be considered jointly.

b. Sources
The New Water Supply Fund receives reserves only from the new water supply fee. Other funds within the new water supply category of funds receive debt proceeds and general use reserves through a designation to this category.

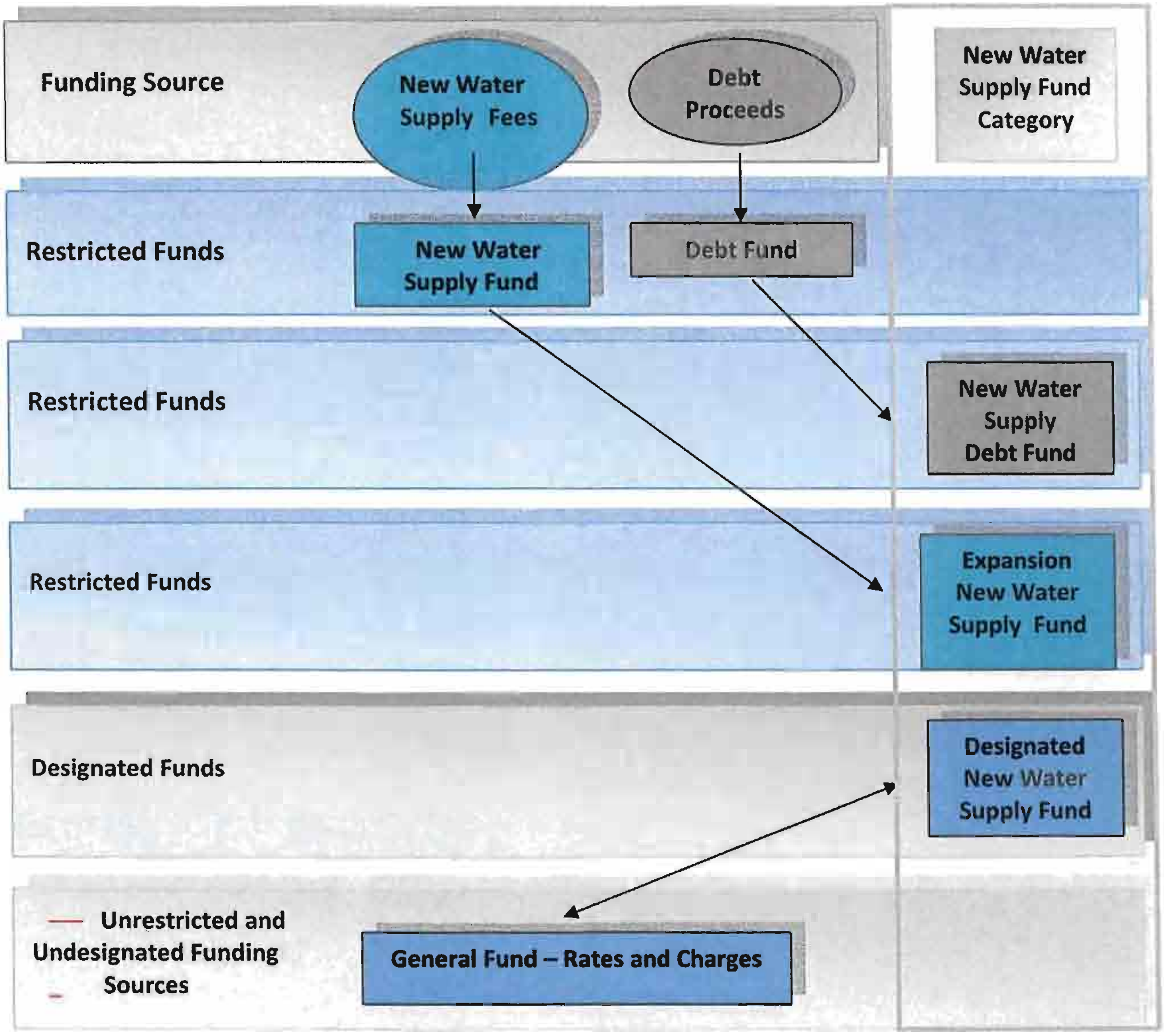
c. Funding Levels

I. **Minimum Level** - As the District matures the CIP will move to purely replacement projects. As the District moves through its lifecycle the need for new water supply reserves will decrease and may be reduced to zero.

II. **Maximum Level** - The maximum reserve level for the new water supply category of funds is limited to five years of the unfinanced new water supply facilities as described in the District's CIP Budget. To determine the unfinanced amount, the total new water supply financing needs must be reduced by the projected new water supply revenues, general fund designations, and bond financing. If the combined new water supply reserves exceed the target level, the District should consider transferring designated reserves to meet other purposes, reduce the new water supply fee, or change the timing of the new water supply projects.

III. **Target Level** - In order to facilitate debt financing of the new water supply, it is important that the various new water supply funds retain an overall reserve level of six months, prior to any attempt to obtain debt financing. This reserve level allows the District the time necessary to issue additional debt without depleting new water supply reserves. If the combined new water supply reserve levels drop below six months of expenditures, this would trigger a transfer of general use reserves, a bond sale, or a change in the timing of new water supply projects. Bond proceeds would be placed in the Restricted New Water Supply Debt Fund while transfers would be placed in the Designated New Water Supply Fund.

Diagram 3.2: New Water Supply Fund Category



~~3.2 Restricted Funds~~

~~a. Purpose~~
~~Restricted cash funds are those that are legally set aside for a particular purpose and cannot be used for any other purpose. The District maintains three Restricted Funds:~~

- ~~Restricted Expansion Fund~~
- ~~Restricted Betterment Fund~~

- ~~Debt Reserve Fund~~

~~The definition and purpose of each of these funds is described below:~~

3.3 Expansion Fund Category

a. Purpose ~~ii. **Designated Expansion Fund**~~

The ~~purpose of this fund~~ Expansion Fund category is to ~~supplement the~~ financ~~inge~~ ~~of~~ the expansion portion of capital projects and therefore is to be paid for by developers. When considering the reserve levels of the expansion category, the following funds work in concert and must be considered jointly: the Expansion Fund, Expansion Debt Fund, Annexation Fund (potable and recycled only), Capital Imporvement Fund, and the Designated Expansion Fund. Potable and recycled reserves are considered jointly while sewer is evaluated separately.

~~Restricted Expansion Fund~~

~~The Restricted Expansion Fund works hand-in-hand with the Designated Expansion Fund. When evaluating the need for additional funding, both the restricted and designated funds must be considered as one fund. The sole purpose of this fund is to construct potable, recycled, and sewer facilities to the extent they serve the expansion needs of the District. Recycled and potable are jointly accounted for as these water systems work in concert. The sewer expansion is accounted for separately but is currently inactive as there is no sewer expansion.~~

~~This fund is restricted by law and therefore is a Restricted Fund that can be used for no other purpose. Government Code section 66001 requires that these funds be accounted for separately and upon request that an accounting be provided. In addition, five years after the first deposit into the account or fund, the Code requires the District make specific findings regarding any unexpended funds, whether those funds are committed to expenditure or not (Government Code section 66001). The same findings must continue to be made once every five years thereafter. If the findings are not made, the statute requires the District refund the fees to the~~

~~current owner of the affected property. The manner of the refund is at the District's discretion.~~

~~As charges are incurred on a project, and the project has been identified as an expansion project, the costs are deducted from the Expansion Fund. This allocation of funds is done on a monthly basis. In the event that funds are not used for the expansion of District facilities the funds must be returned to the developers who paid them. In the case where a policy change requires a betterment project that would have been an expansion project at the time the capacity fee was collected, reserves may be used for that betterment project. The expansion reserves may also be used for bond repayment, to the extent the debt was incurred to fund expansion.~~

b. Sources

The Expansion Fund is financed by water charges in lieu of capacity fees (for temporary meters) and the "incremental" portion of the capacity fee. The other funds in this category may also be financed by debt proceeds, annexation fees, the "buy-in" portion of the capacity fee, and the general fund through a designation of reserves.~~In the event the restricted expansion funds are not sufficient to fund the expansion projects these funds may be used. This fund must be evaluated in conjunction with the Restricted Expansion Fund as they work in concert.~~

~~I. Designated Expansion Fund~~

c. Funding Levels

~~A.~~ I. **Minimum Level** - As the District matures the CIP will move to purely replacement and betterment projects. As the District moves through ~~its~~ this lifecycle the need for expansion ~~funds~~ reserves will decrease and ~~eventually~~ may be reduced to zero. ~~When considering the funding of expansion the Restricted Expansion Fund and the Designated Expansion Fund work in concert and must be considered jointly.~~

~~B.~~ II. **Maximum Level** - The maximum reserve level ~~of~~ for ~~this~~ the expansion category of fund~~s~~ is limited to five years of ~~unfunded~~ unfinanced expansion ~~needs~~ facilities as described in the District's CIP

Budget. To determine the ~~unfunded~~ unfinanced amount, the total ~~expansion~~ financing ~~costs~~ needs must be reduced by the projected ~~restricted~~ expansion revenues, ~~.~~ ~~B~~bond financing, and any restricted or general fund revenues allocated to this fund category. ~~is expected to fund a large portion of expansion.~~ If the combined expansion reserves exceed target levels, the District should consider reducing capacity fees, reallocating restricted or designated funds to meet other purposes, or shifting the timing of expansion projects.

~~C.~~ III. **Target Level** - The target level is six months of expansion expenditures. ~~In order to facilitate debt financing of expansion, i~~It is important that the expansion ~~funds~~ reserves ~~retain a reserve~~ remain at a minimum of six months ~~prior to any attempt to obtain bond financing.~~ Of expansion expenditures. This reserve level allows the District the time necessary to issue additional debt without ~~running out of~~ depleting expansion ~~funds~~reserves. If the combined expansion ~~funds~~ reserves drop below six months of expenditures this would trigger ~~either~~ a transfer of general use ~~funds~~ reserves ~~or a borrowing of funds with~~ a bond sale, an adjustment to the timing of expansion projects, or a reallocation of restricted reserves. Bond ~~funds~~ proceeds would be placed in the Restricted ~~Expansion~~ Bond Fund, ~~while~~ transfers of general use reserves would be placed in the Designated Expansion Fund, and transfers of restricted reserves would be placed in either the Expansion Annexation Fund or the Expansion Capital Improvement Fund. ~~If the combined expansion funds exceeded target the District should considered the need to reduce capacity fees or transferring designated funds to meet another purpose.~~

~~b. Levels~~

~~i. Restricted Expansion Fund~~

~~A. **Minimum Level** - While there is no minimum balance, an action is required when the balance of the combined Restricted Expansion Fund and the Designated Expansion Fund drops below six months of~~

~~expenditures. This would trigger either a transfer of funds from a non-Restricted Fund or a borrowing of funds with a bond sale. Bond funds would be placed in the Restricted Expansion Fund while transfers would be placed in the Designated Expansion Fund.~~

~~B. **Maximum Level** - The maximum of this fund is limited not by a particular dollar amount but by the limited ability to collect funds for this purpose. This limitation is mandated by Government Code section 66001. Under the Code, the District must identify the purpose of the fee and the use to which it will be put, effectively establishing a nexus between the development project or class of project and the improvement being financed. The District must further establish that the amount of the funds being collected will not exceed that needed to pay for the improvement (Government Code section 66005).~~

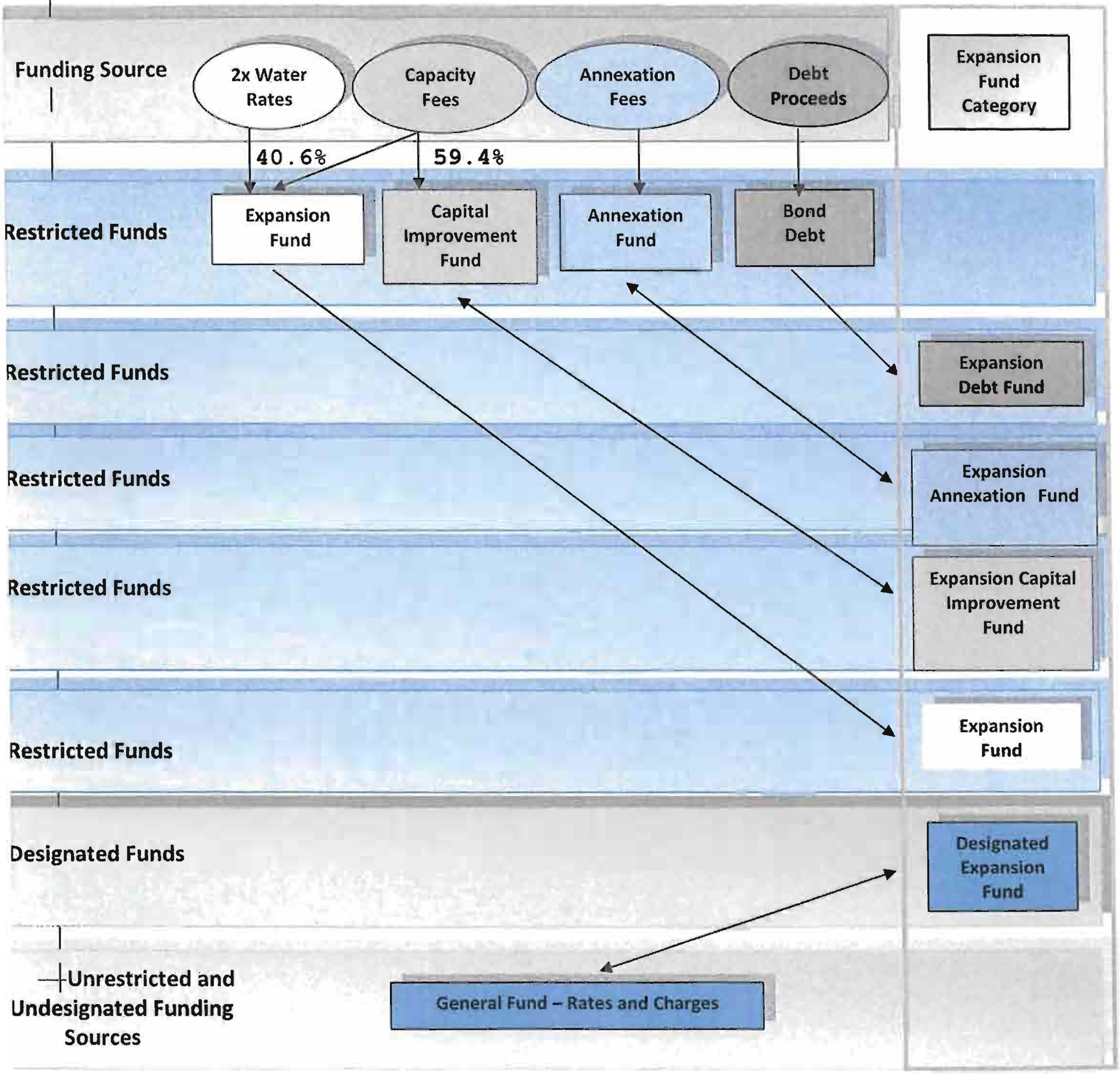
~~Under this mandate, also referred to as AB 1600, the Mitigation Fee Act and Government Code sections 66000 et seq., the District can only collect capacity fees for expansion projects. To insure compliance with this, the District performs periodic rate studies, a part of which is the calculation of the legally defensible capacity fee. Therefore, the District is limited in this fund by the nexus between the need for expansion expenditures and the fee that is approved for its collection.~~

~~With the lack of a dollar limitation for the maximum, it is incumbent on the District to maintain the planned construction of capital infrastructure. While building ahead of the need makes it unlikely that the capacity fees will accumulate to any great degree, significant delays in construction may result in high levels of the Restricted Expansion Fund. This is one reason why the District reports to the Board on a periodic basis the progress of the CIP spending. Further, the annual update of the rate model brings the Restricted and Designated Expansion Fund balances to the Board's attention.~~

~~Also, the District provides annual Developer meetings where the existing and projected reserve levels are reviewed.~~

~~C. **Target Level** - In order to facilitate debt financing of expansion, it is important that the expansion funds retain a reserve of six months prior to any attempt to obtain bond financing. This reserve allows the District the time necessary to issue additional debt without running out of expansion funds.~~

Diagram 3.3: Expansion Fund Category



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~~There is significant interdependency between the District's potable and recycled water systems. For this reason, the two systems are supported by one combined capacity fee. The same capacity fee is charge on all water connection regardless of whether they are potable or recycled. For this reason the Restricted and Designated Expansion Funds for these two business segments must be considered jointly when using the rate model and setting fees.~~

~~The District currently has not sewer expansion and therefore has no sewer capacity fees and no active sewer expansion funds.~~

~~This fund contains general use funds and at the direction of the Board may be used for any District purpose.~~

3.4 Replacement Fund Category

~~iv.~~

a. ~~The p~~Purpose

The Replacement Fund category is to finance replacement projects. When considering the reserve levels of the replacement category of funds, th following funds work in concert and must be considered jointly: the Annexation Fund, Debt Fund, Capital Improvement Fund, and the Designated Replacement Fund. The purpose of these reseveres ~~of this fund~~ is to pay for the replacement of capital infrastructure and capital purchases. ~~This is a Designated Fund and was created to meet a portion of the District's replacement needs. This fund is~~ These reserves are not to be used for the replacement of non-capital items.

~~Debt financing of replacement will be the primary source of funds for replacement however; this reserve is established to fund a portion of replacement and ensure that necessary replacements will occur regardless of the immediate availability of the debt markets.~~ With the District's development of its financial systems and the greater need and ability to separate and track reserves~~funds~~, the ~~R~~replacement ~~Fund~~ reserves ~~has~~ have been separated into three funds: water, recycled, and sewer.

Projects undertaken solely for the purpose of replacing major capital equipment or facilities, *i.e.*, where the cost exceeds $10,000 for capital purchases or $20,000 for infrastructure items, generally these are not considered normal maintenance. ~~Where~~ When the cost is below $10,000, the costs are financed annually as operational maintenance. As charges are incurred on ~~a~~ replacement projects the ~~funds~~ reserves are deducted from the respective Replacement Funds on a monthly basis.

~~This is a Designated Fund and may be redirected for any purpose at Board direction.~~

b. Sources

~~c.~~ The various funds in this category are financed by debt proceeds, annexation fees, the "buy-in" portion of the capacity fee, and general fund designations.

~~The sources of funding for designated funds are limited to interfund transfers from available unrestricted funds (see 3.0 b.) and interest earnings on fund balances within designated funds. Unrestricted funds may come from other designated funds or from the General Fund. The operating budget is another source of designated general revenues. As a part of the normal budget process the general revenues are sufficient to fund a significant portion of the ongoing needs of the designated funds.~~

~~II. Replacement Fund~~

c. Funding Levels

~~A.~~I. **Minimum Level** - The minimum reserve level of this category of ~~funding~~ funds is 3% of the historical value of existing assets as identified in the District's current financial statement. Potable, recycled, and sewer replacement are evaluated separately.

~~B.~~II. **Maximum Level** - The maximum reserve level of this category of ~~funding~~ funds is 6% of existing assets. If the combined replacement reserves exceed target levels, the District should consider transferring annexation fees or the "buy-in" portion of the capacity fee to meet other purposes. Another consideration would be to shift the timing of replacement projects. ~~In the event the maximum level is exceeded~~

~~in any year, then the excess will be transferred as per the general transfer guidelines found in Section IV.~~

~~C.~~III. **Target Level** - The target reserve level of this category of ~~funding~~ funds is 4% of existing assets. In the event that the ~~fund~~ reserves falls~~s~~ below the recommended target level, the District should consider transfer~~s~~ring annexation fees or the "buy-in" portion of the capacity fee. ~~or operating revenues would be shifted to support the Replacement Funds.~~ The District

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should also consider shifting the timing of replacement projects or issuing debt to support the planned level of facility replacement. The District will act based on the annual ~~five (5)~~ six-year rate ~~study~~ model, to insure that at the end of that planning horizon the ~~fund~~ reserves exceed~~s~~ the minimum level and is approaching the target level.

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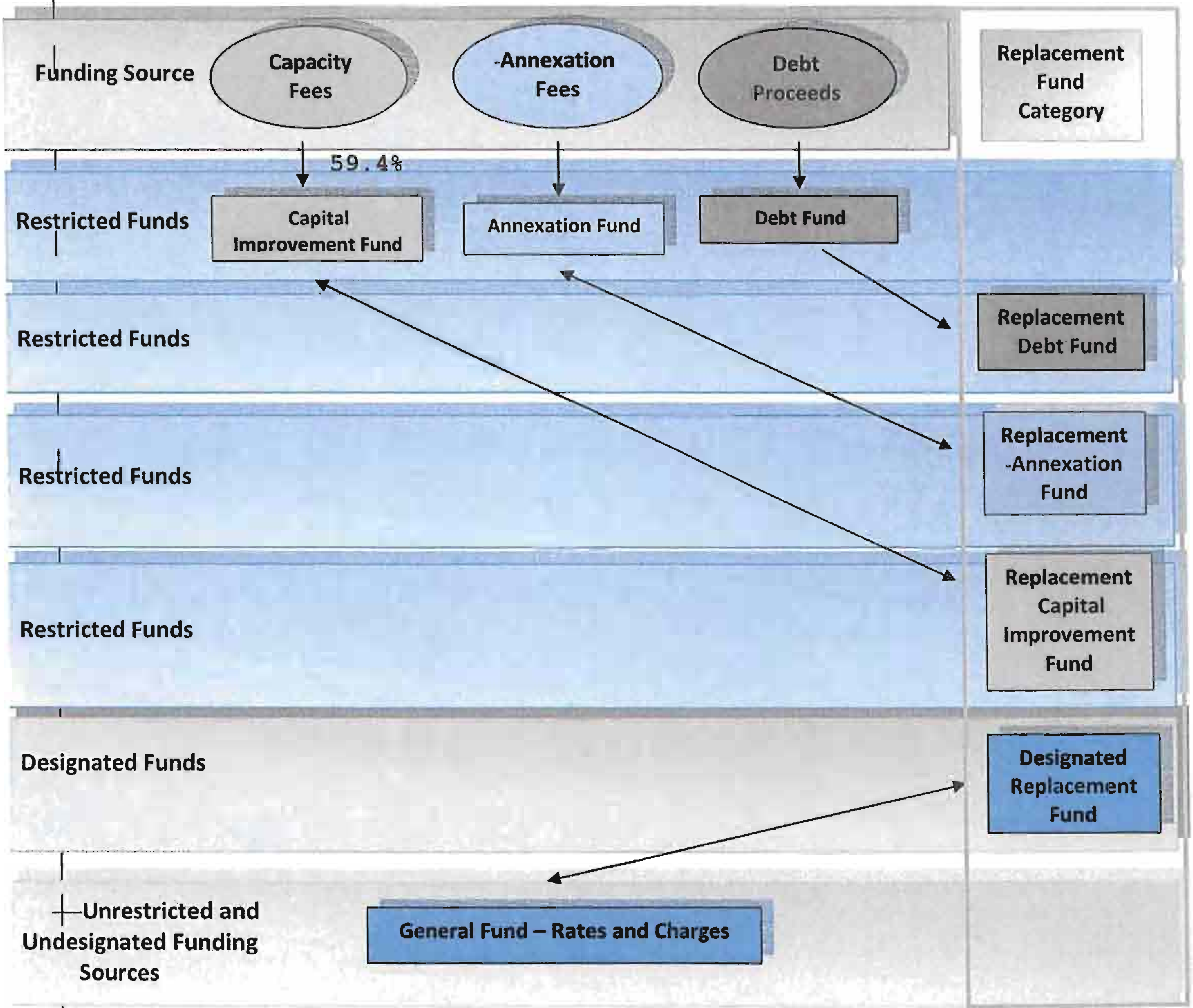
Diagram 3.4: Replacement Fund Category



3.5 Betterment Fund Category

a. Purpose~~ii. Restricted Betterment Fund~~

The Betterment ~~Reserve~~ Fund Category is to finance the betterment portion of capital projects with a portion going to the maintenance of ~~covers the cost to construct, install, and in some cases to maintain~~ the potable, recycled, and sewer systems. The District maintains ~~three~~ separate ~~designated b~~Betterment ~~f~~Fund~~s~~ categories, one for each ~~business segment~~improvement district. An improvement district is a legally defined geographic area usually established for the purpose of bond financing of facilities. The betterment reserves within ~~T~~these funds are restricted by law for use within the ~~area~~ improvement district in which the fees ~~are~~ were collected (Water Code 71631.6). However, the legal restriction of this ~~fund~~ reserve depends upon the particular revenue source. (see Section 2.1 f. for a review of the special rates and availability fees).

When considering the reserve levels of the betterment category of funds, the following funds work in concert and must be considered jointly: the Betterment Fund, Annexation Fund (potable and recycled only), Debt Fund, Capital Improvement Fund, and Designated Betterment Fund.

~~iii. **Designated Betterment Fund**~~

~~The purpose of this fund is to supplement the Restricted Betterment Fund for sewer, water, or recycled. The District maintains three separate designated betterment funds, one for each business segment. In the event a Restricted Betterment Fund is not sufficient to fund betterment projects this fund will be used. This fund must be evaluated in conjunction with the Restricted Betterment Fund as they work in concert. When considering the funding levels for betterment funds there are multiple sub-funds within betterment that must be individually considered (see 2.1 f.). This is a general use fund and at the direction of the Board may be used for any District purpose.~~

b. Sources

The Betterment Fund category receives restricted revenues by improvement district via special water rates and from availability fees collected through the county tax roll. Betterment may also be financed by debt proceeds, annexation fees, the "buy-in" portion of the capacity fee, as well as the general fund through a designation of reserves.

Funding Levels

~~I.~~ I. **Minimum Level** - As the District matures the CIP will move to purely replacement projects. As the District moves through ~~its~~ this lifecycle the need for betterment ~~funds~~ reserves will decrease and ~~eventually~~ may be reduced to zero. ~~When considering the funding of expansion the Restricted Betterment Fund and the Designated Betterment fund work in concert and must be considered jointly.~~

~~B.~~ II. **Maximum Level** - The maximum reserve level ~~of this~~ for the betterment category of funds is limited to five years of ~~unfunded~~ unfinanced betterment ~~needs~~ facilities as described in the District's CIP Budget. To determine the ~~unfunded~~ unfinanced amount, the total ~~betterment~~ financing ~~costs~~ need must be reduced by the projected ~~restricted~~ betterment revenues, ~~. B~~bond financing, ~~is expected to fund a large portion of betterment.~~ annexation, and general fund designations. If this maximum is exceeded, then the District should evaluate reductions in the special water rates and availability fees, transferring designated reserves to meet other purposes, or shifting the timing of betterment projects.

~~C.~~ III. **Target Level** - The target is six months of betterment expenditures. ~~In order to facilitate debt financing of betterment, i~~It is important that the betterment ~~funds~~ reserves ~~retain~~ remain at a ~~reserve~~ minimum of six months of betterment expenditures. ~~prior to any attempt to obtain bond financing~~. This reserve level allows the District the time necessary to issue additional debt without ~~running out of~~ depleting betterment ~~funds~~reserves. ~~When considering the funding levels for betterment funds there are multiple sub-funds within betterment that must be individually considered (see 2.1 f.).~~ If the combined betterment ~~funds~~ reserves drop below six months of expenditures this would trigger ~~either~~ a transfer of general use ~~funds~~ reserves~~or a borrowing of funds with~~ a bond sale, or an adjustment to the timing of betterment projects. Bond ~~funds~~ proceeds would be placed in the ~~Restricted~~ Betterment Bond Fund while transfers would be placed in the Designated Betterment Fund. ~~If this target is exceeded, then the District should evaluate reductions in the special water rates and availability fees and also consider transfers to other funds.~~

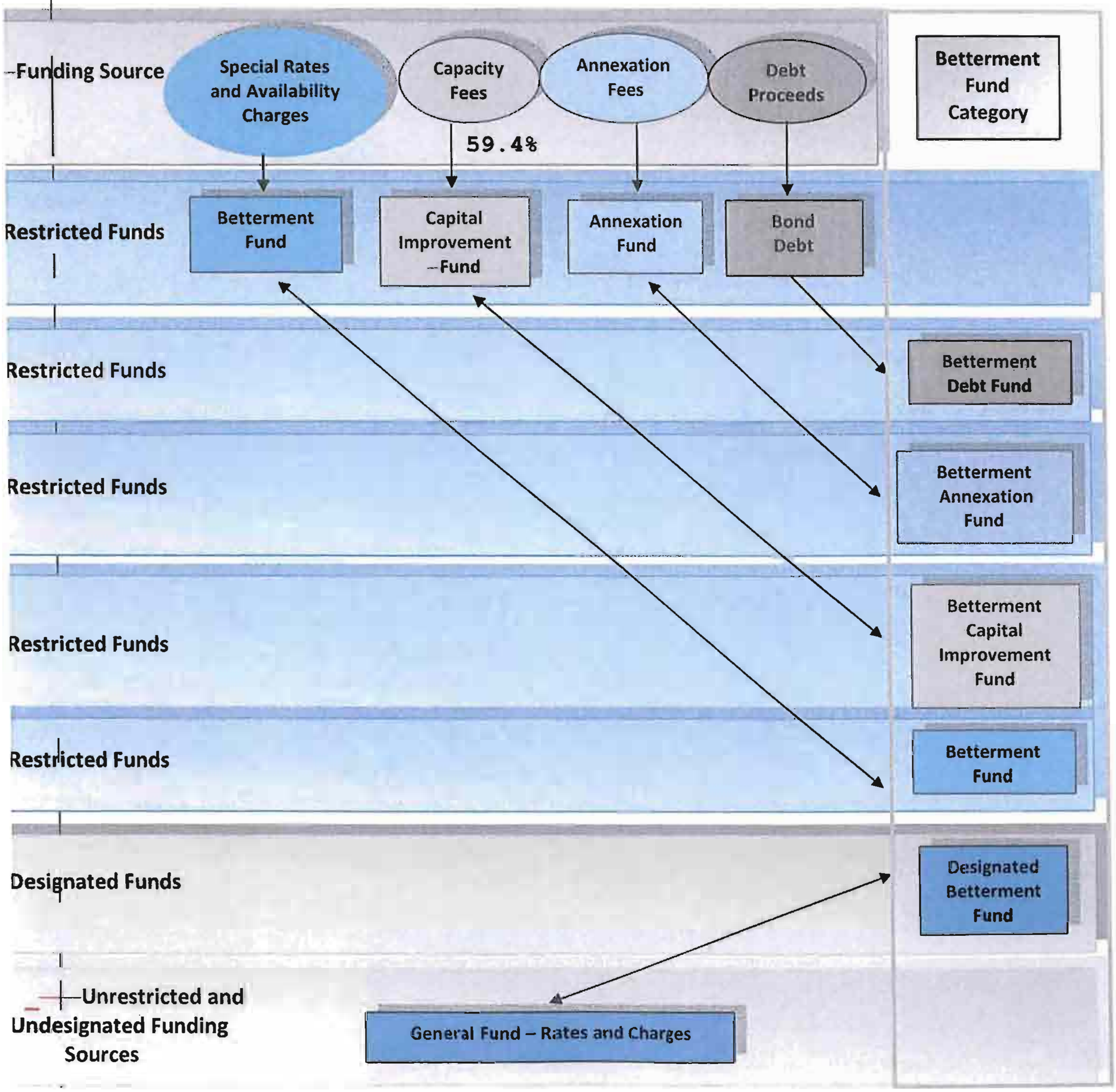
~~ii. Restricted Betterment Fund~~

~~A. **Minimum Level** – While there is no minimum, less than six months of available funds in the combined Restricted Betterment and Designated Betterment Funds would trigger either a transfer of funds from a non-Restricted Fund or a borrowing of funds with a bond sale. Bond funds would be placed in the Restricted Betterment Fund while transfers would be placed in the Designated Betterment Fund.~~

~~B. **Maximum Level** – The maximum to be retained in this fund is five years of unfunded CIP betterment expenditures as defined in the CIP budget forecast. To determine the unfunded amount the total betterment costs must be reduced by the projected restricted betterment revenues. If this maximum is exceeded, then the District should evaluate reductions in the special water rates and availability fees and also consider transfers to other funds.~~

~~C. **Target Level** – In order to facilitate debt financing of betterment, it is important that the betterment funds retain a reserve of six months prior to any attempt to obtain bond financing. This reserve allows the District the time necessary to issue additional debt without running out of betterment funds. When considering the funding levels for betterment funds there are multiple sub-funds within betterment that must be individually considered (see 2.1 f.).~~

Diagram 3.5: Betterment Fund Category



~~DIAGRAM 3.0: Fund Targets~~

~~FUND~~	~~ACTIONS TO CONSIDER IF BELOW TARGET~~	~~TARGET~~	~~MAXIMUM~~
~~Restricted Expansion Fund *~~	~~Capacity fee increase Bond financing~~	~~Six months of capital expenditures~~	~~Nexus of cost to fee~~
~~Restricted Betterment Funds **~~	~~Rate increase Bond financing~~	~~Six months of capital expenditures~~	~~5 yr unfunded needs~~
~~Debt Reserve Fund~~	~~Increase tax collection~~	~~One semi-annual payment~~	~~Two semi-annual payments~~
~~Designated Expansion Fund *~~	~~Fund transfers~~	~~Six months of capital expenditures~~	~~5 yr unfunded needs~~
~~Designated Betterment Fund **~~	~~Fund transfers~~	~~Six months of capital expenditures~~	~~5 yr unfunded needs~~
~~OPEB Fund~~	~~Fund transfers~~	~~Full funding~~	~~Full funding~~
~~Replacement Fund~~	~~Fund transfers~~	~~4% of infrastructure~~	~~6% of infrastructure~~
~~General Fund~~	~~Rate increase Fund transfers~~	~~Three months of operating budget expenses~~	~~Nine months~~

~~* Expansion needs must consider the Restricted and Designated Expansion Funds as well as any available bond financing.~~

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~~** Betterment needs must consider the Restricted and Designated Betterment Funds as well as any available bond financing~~

Diagram 3.6: Fund Targets

Fund or Fund Category	Actions to Consider if below Target	Target	Maximum
New Supply Fund Category	New supply fee increase, bond financing, or transfer to designation or to CIF or Annexation Fund	Total of all funds in fund category = six months of capital expenditures	Nexus of cost to fee
Expansion Fund Category	Capacity fee increase, bond financing, or transfer to designation or to CIF or Annexation Fund	Total of all funds in fund category = six months of capital expenditures	Nexus of cost to fee
Replacement Fund Category	Bond financing, or transfer to designation or to CIF or Annexation Fund	Total of all funds in fund category = 4% of infrastructure	Nexus of cost to fee
Betterment Fund Category	Bond financing, or transfer to designation or to CIF or Annexation Fund	Total of all funds in fund category = six months of capital expenditures	5 years unfunded needs
Debt Reserve Fund	Increase tax collection or rates	One semi-annual payment	Two semi-annual payments
OPEB Fund	Fund transfers	Full funding	Full funding
General Fund	Rate increase or fund transfers	Three months of operating budget expenses	Nine months of operating budget expenses

Note: The annexation fee for sewer is a general fund revenue.

Additional Restricted Funds

4.0 Capital Improvement Fund

a. Purpose
The "Capital Improvement Fund's sole purpose is to track the "buy-in" portion of the capacity fee and to ensure these fees are expended solely for the purpose for which they were collected, which in this case is to pay for facilities that were in existence at the time this fee was established. These fees may be used for expansion, replacement, or betterment projects or any debt related to these categories. These fees may also be used for either the potable or the recycled systems. As capacity fees are collected, the "buy-in" portion of the fee is allocated as needed to one of three capital improvement funds, one in each of the Expansion, Replacement, and Betterment Fund categories. These reserves are used to pay debt or offset any negative balance within these three categories of funds. These fees may not be used to finance the New Water Supply category, as there were no new water supply facilities in existence at the time the new methodology for capacity fees was established.

b. Sources
The "buy-in" portion of the capacity fee collected after June 30, 2010.

c. Funding Levels
There are no minimums, maximums, or target levels for these reserves on an individual basis. The allocation of this fee to the various capital improvement funds is dependent on the overall reserve levels within each fund category.

4.1 Annexation Fund

a. Purpose
The Annexation Fund's sole purpose is to track the potable and recycled annexation fees collected and to ensure these fees are expended solely for the purpose for which they were collected. The annexation fees may be used for expansion, replacement, or betterment projects or any debt related to these categories. These fees may be used for either the potable or recycled systems. These reserves may not be used to finance the New Water Supply category, as it was not in existence at the time the fee was established. As these fees are collected they are allocated as

needed to one of three capital improvement funds, one in each of the Expansion, Replacement, and Better Fund categories.

b. Sources

Potable and recycled annexation fees collected after June 30, 2010.

c. Uses

There are no minimums, maximums, or target levels for these reserves on an individual basis. The allocation of this fee to the various Annexation Funds is dependent on the overall reserve levels within each fund category.

~~iii.~~4.2 Debt Reserve Fund

~~The purpose of the Debt Reserve Fund is to pay periodic principal and interest debt payments on the outstanding debt. As these payments are made the funds are reduced. As additional debt is incurred, new property tax assessments may be authorized funded from assessments on the Property Tax Roll. Annually, the District sets the tax rate at a level necessary to fund that year's debt payments. These rates are applied to the assessed valuation of the property. Changes in property values in assessment areas result in inverse fluctuations in the tax rate necessary to generate the required debt payments.~~

~~In other cases, such as assessment districts, the debt service is funded through an assessment being levied on each parcel within the district. In assessment districts, the amount of the levy will vary by parcel and is based on the amount of benefit that parcel received from the improvement.~~

~~In addition, debt service may be funded through water rates. In the case of funding from water rates, there would not be a restriction on those debt reserve funds. They may remain in the General Fund or be placed in a Designated Fund if the Board were to take specific action to designate rate funds for the purpose of debt payments.~~

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~~These funds are legally restricted for the specific debt issuance for which they are collected. These funds are not available for any other purpose and may not be designated for any other purpose. If these funds are not used for the payment of the specific debt for which they are collected they must be returned to the customers who made the tax roll payments. The District must evaluate the exact need of funds to avoid the costly reimbursement process.~~

a. Purpose
The Debt Reserve Fund is established to hold the proceeds from the various debt issuances. There are two types of debt, General Obligation bonds and Certificates of Participation bonds. The proceeds are transferred to the New Water Supply, Expansion, Replacement, or Betterment Debt Funds as they are expended for various facilities within those fund categories. As repayment of the debt occurs, the balances within these individual funds are reduced so that the financial impact of issuing debt is tracked within the category for which the debt was issued.

~~a. Sources~~
~~Temporary meter fees and capacity fees fund expansion while special rates and charges and availability charges fund the betterment fund. The debt reserves are funded by the State Loan Assessment, and GO bond assessments. Each debt fund can also be funded with the proceeds of the debt. Lastly, each fund is allotted its share of the interest income or expense.~~

b. Sources
Debt proceeds.

~~iii. Debt Reserve Fund~~

~~A. **Minimum Level** - As debt service payments are made the funds may be completely depleted if no other payments are required.~~

~~B. **Maximum Level** - Sufficient to pay the periodic annual debt service payments. As levels approach this maximum, the District must evaluate the rate at which funds are being collected so as to not over collect. Reductions in the tax rates have~~

~~been common as property values have risen. Even if the maximum is exceeded, no refunds would occur if future debt payments are necessary. The action required if funds exceed the maximum is a reduction of the rate of collection which will bring the balance down over time.~~

~~C. **Target Level** - The target level of funds for the various debt issuances is six months of debt service. This target level will be reduced as the term of the debt comes to a close.~~

c. Uses
There are no minimums, maximums, or target levels for this fund on an individual basis. This fund is available on an as needed basis to fund CIP projects for new water supply, expansion, replacement, or betterment. From a funding level perspective, these reserves are evaluated in the context of all the various funds within each fund category.

Fund Transfers
~~**FUND TRANSFERS**~~

45.0 Funding Levels

As described in the preceding sections, the District maintains funds for its operating and capital activities. These ~~funds~~ reserves ~~fall into~~ can be of three ~~accounting categories;~~ types: 1) ~~unrestricted and~~ undesignated~~,~~ or general use ~~funds~~reserves, 2) designated, and 3) restricted for a specific purpose. The restricted reserves can be restricted geographically and/or by purpose. The District maintains various funds to track the various designations and restrictions. The source of the money for each fund was discussed along with the purpose, source of funds, and levels. Key ~~determinants~~ characteristics of these funds are the target levels, minimums, and maximums. The funding levels must be viewed in the context of the economic environment, political environment, and ~~must always be viewed~~ in light of ~~a~~ the District's rate model. The District's six-year rate model not only shows the current balance but also shows the trend of the fund balances. Often the trend of the fund is a greater indicator of financial stability than is the current balance.

The rate model is updated each year with the budget process and evaluates each fund over the next six years. The rate model will take into account the general economic environment, looking at the development rate, supply rate increases, the possibility of raising rates, capital infrastructure spending, and strategic plan initiatives. The fund balances may at times be over the target amount or under the target amount. This is not only acceptable but expected. The rate model provides an empirical estimate of the conformance between the projected District's financial activities and the guidelines of this policy.

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~~4~~5.1 Fund Transfers

~~A significant portion of the funding for~~ Reserves within the District's various designated funds come~~s~~ from interfund transfers ~~from~~ of ~~the~~ ~~U~~unrestricted ~~or G~~general use ~~Funds~~reserves. It is important to note that the District has the ability to use ~~G~~general use ~~Funds~~ reserves for any business purpose. General ~~Funds~~ use reserves may be transferred to and from any ~~other~~ unrestricted fund for any business need. Designated ~~funds~~ reserves are ~~G~~general use ~~Funds~~ reserves which have been set aside for a specific purpose by Board action. These ~~funds~~ reserves can only be used for the purpose they were designated, or with Board action~~,~~ they may be used for any other business purpose. While ~~G~~general ~~Funds~~ use reserves may ~~also~~ be used for any restricted purpose ~~but are~~ they may not be transferred to Restricted Funds due to the sensitivity of the tracking of ~~R~~restricted ~~Funds~~ reserves. If ~~funds~~ reserves are needed for a restricted purpose they are transferred to a Designated Fund within the fund category with that particular ~~identified with the restricted~~ purpose. Reserves restricted to a fund category may only be used within that category and may not be transferred to another category. For example, the new water supply fee and the "incremental" portion of the capacity fee are restricted reserves for a specific purpose, and may not be transferred to another category as no other category has the same purpose. However, the "buy-in" portion of the capacity fees and annexation fees are restricted for purposes that are shared by more than one category of funds and may therefore be transferred to a restricted fund within another fund category as long as it shares the same purpose.
~~Restricted Funds may only be used for the purpose that they were collected therefore no transfers are made to or from these funds.~~

In many situations~~,~~ reserve ~~fund~~ transfers are expected as some fund~~s~~ categories will exceed their maximum or drop below their minimum~~s~~. Only funds that are below the stated target are eligible to receive transferred funds. Only fund categories that are below the stated target are eligible to receive transferred reserves. Fund~~s~~ categories that exceed their maximum~~s~~ are first to be considered for transfers out, followed by funds that exceed their targets. Funds that exceed their minimums are also available for ~~fund~~ reserve transfers out, but only when other options are not available.

The rationale for prioritizing ~~fund~~ reserve transfers is based on the immediacy of the need and the availability of ~~funds~~ reserves from other funding sources. For example, the General Fund is first to receive ~~funds~~ reserves when it drops below its target or minimum levels. This is because of the immediate and ongoing nature of the expenditures that are served by this fund. The operation of the District is first and foremost of the objectives of the District. On the other end of the spectrum, the Replacement Fund has a long-term perspective and will be used to partially ~~fund~~ finance replacement assets for many years to come. Debt financing is available to respond to this long term~~,~~, foreseeable, and planned cash flow. This fund is less likely to have immediate needs and has other ~~funding~~ financing options.

When making the determination of when transfers are necessary, all funds ~~work~~ within a fund category work as a group~~as independent funds~~. The combined balance of the restricted and designated funds is looked at when determining whether the fund category requires additional funding from the Restricted Capital Improvement Fund, Restricted Annexation Fund, Restricted Debt Fund, or the General Fund. ~~exceptions to this rule are the two expansion funds (one restricted and one designated) and the two betterment funds (one restricted and one designated).~~ Because the Capital Improvement Fund and Annexation Fund may finance expansion, replacement or betterment reserves may be transferred among these fund categories, but only back and forth within its own type of restricted fund. ~~Each of these two sets of funds work as one but are kept separate due to the significant difference in the fund types, one being restricted and one originating from General Funds. It is unlikely to have high immediacy of need in these funds as they, like the Replacement Fund, are long term in nature and have debt financing as an alternative funding source.~~

As an example, if during the rate model update process it was determined that the ~~e~~Expansion ~~f~~Funds (designated and restricted) would drop and stay below the minimum during the six-year planning horizon, this would trigger a bond sale ~~or~~ a transfer of ~~unrestricted funds~~ general use reserves, and/or a transfer of restricted reserves. If in the cash planning process, it was anticipated that the General Fund would remain above target during the planning horizon ~~of six (6) years~~ and that the trend did not present a problematic underfunded status, then ~~those funds~~ General Fund reserves would be considered available for transfer prior to making ~~funds~~ proceeds available from ~~the sale of~~ a bond sale~~s~~. Also, if during this period the Betterment Fund category ~~another Designated Fund~~ was anticipated to exceed its maximum, then reserves from either the Designated Betterment Fund, the Annexation Fund, or the Capital Improvement Fund ~~the excess~~ would be transferred to the corresponding ~~Designated~~ Expansion Fund prior to ~~any other transfers~~ a bond sale. All ~~F~~funds are evaluated to determine which has the greatest need or availability of ~~funds~~ reserves before any ~~fund~~ reserve transfer recommendation is presented to the Board.

OTAY WATER DISTRICT **BOARD OF DIRECTORS POLICY**			
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GLOSSARY

The Reserve Policy contains terminology that is unique to public finance and budgeting. The following glossary provides assistance in understanding these terms.

Annexation Fees: ~~Whenever utility~~ When water service is requested for land outside the boundaries of ~~an improvement~~ the ~~d~~District, the land to be serviced must first be annexed. For sewer service the land must be annexed into an improvement district within the District. ~~The annexation fee for water was set on March 3, 1997 at $1,000 per EDU. The fee for sewer annexation was set at $3,819 on December 16, 1998. These base rates are adjusted quarterly according to a cost of living index.~~

Assets: Resources owned or held by Otay Water District that has monetary value.

Availability Fees: The District levies charges each year in developed areas to be used for upgrades, betterment, or replacement and in undeveloped areas to provide a source of funding for planning, mapping, and preliminary design of facilities to meet future development. Current legislation provides that any availability charge in excess of $10.00 per acre shall be used only for the purpose of the improvement district for which it was assessed.

Betterment Fees: In addition to other applicable water rates and charges, water customers pay a fee based on water service zone or Improvement District. These fees are restricted for use in the area where they are collected and may be used for the construction and maintenance of facilities.

Bond: A written promise to pay a sum of money on a specific date at a specified interest rate. The interest payments and the repayment of the principal are authorized in a District bond resolution. The most common types of bonds are General Obligation (GO) bonds and Certificates of Participation (COPs). These are frequently used for construction of large capital projects such as buildings, reservoirs, pipelines and pump stations.

Capital Equipment: Fixed assets such as vehicles, marine equipment, computers, furniture, technical instruments, etc. which have a life expectancy of more than two years and a value over $10,000.

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Capital Improvement Program: A long-range plan of the District for the construction, rehabilitation and modernization of the District-owned and operated infrastructure.

CWA: The County Water Authority was organized in 1944 under the State County Water Authority Act for the primary purpose of importing Colorado River water to augment the local water supplies of the Authority's member agencies. The Authority purchases water from the Metropolitan Water District of Southern California (MWD) which imports water from the Colorado River and the State Water Project.

Debt Service: The District's obligation to pay the principal and interest of bonds and other debt instruments according to a predetermined payment schedule.

Expenditures/Expenses: These terms refer to the outflow of funds paid or to be paid for an asset, goods, or services obtained regardless of when actually paid for. (Note: An encumbrance is not an expenditure). An encumbrance reserves funds to be expended in a future period.

Fund: An account used to track the collection and use of monies for a specifically defined purpose.

Fund Balance: The current funds on hand resulting from the historical collection and use of monies. The difference between assets and liabilities reported in the District's Operating Fund plus residual equities or balances and changes therein, from the results of operations.

Interest Income: Earnings from the investment portfolio. Per District Policy Number 25, interest income will be allocated to the various funds each month based upon each fund's prior month-ending balance.

Late Charges/Penalties: Charges and penalties are imposed on customer accounts for late payments, returned checks, and related telephone contacts.

1% Property Tax: In 1978, Proposition 13 limited general levy property tax rates for all taxing authorities to a total rate of 1% of full cash value. Subsequent legislation, AB 8, established that the receipts from the 1% levy were to be distributed to taxing agencies according to approximately the same proportions received prior to Proposition 13. Funds received are to be used for facilities construction or debt service on bonds sold to build facilities.

Operating Budget: The portion of the budget that pertains to daily operations that provide basic governmental services. The operating budget contains appropriations for such expenditures as personnel, supplies, utilities, materials, travel and fuel, and does not include purchases of major capital plant or equipment which is budgeted for separately in the Capital Budget. The Operating Budget also identifies planned non-operating revenues and expenses.

Revenue: Monies that the District receives as income. It includes such items as water sales and sewer fees. Estimated revenues are those expected to be collected during the fiscal year.

System Fees: Each water service customer pays a monthly system charge for water system replacement, maintenance, and operation expenses. The charge is based on the size of the meter and class of service.

Taxes: California Water Code Section 72091 authorizes the District, as a municipal water district, to levy ad valorem property taxes which are equal to the amount required to make annual payments for principal and interest on General Obligation bonds approved by the voters prior to July 1, 1978.

Water Rates: Rates vary among classes of service and are measured in units. The water rates for residential customers are based on an accelerated block structure. As more units are consumed, a higher unit rate is charged. All non-residential customers are charged a flat rate per unit. A unit of water is 100 cubic feet or 748 gallons of water.

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1.0 The District

The Otay Water District is a California municipal water district, authorized in 1956 by the State Legislature under the provisions of the Municipal Water District Act of 1911. The District is a "revenue neutral" public agency; meaning each end user pays their fair share of the District's costs of water acquisition, construction of infrastructure, and the operation and maintenance of the public water facilities.

The District provides water service within its boundaries, and provides sewer and recycled water service within certain portions of the District. As such, the District operates three distinct business segments:

- Potable water
- Recycled water
- Sewer

Each of these business segments has an identifiable customer base. In addition, the developer community, large and small, makes up a significant class of customer for each business segment. As a result, the District has four distinct customer service types:

- Developers
- Potable water users
- Recycled water users
- Sewer users

The District has established practices and developed computer systems that have enabled the District to maintain a clear separation between the service costs relating to each of its four customer service types. Regardless of customer class, financial principles regarding cost allocation and fund accounting are fundamental to the District's Reserve Policy. These principles are derived from the statements of the Governmental Accounting Standards Board (GASB), and from oversight and advisory bodies such as the California State Auditor, the Little Hoover Commission, and the Government Finance Officers Association (GFOA). These have significant impacts on how the finances of the District are organized and how financial processes work within the organization.

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1.1 The District's Use of Financial Resources

All of the District's expenditures fall into two broad categories: operating costs and capital expenditures. The operating costs include costs relating to the purchase and delivery of potable and recycled water, and the transportation and treatment of sewage. The capital expenditures support the construction of infrastructure necessary to deliver services. The District uses various funds to support the operating and capital efforts. Operations and maintenance is financed only by rates and charges, also called pay-as-you-go, while capital infrastructure is financed using two financing methods: pay-as-you-go and debt issuance (requiring annual debt service). The Capital Improvement Program (CIP) and the two funding methods support the construction, betterment, and replacement of infrastructure in all three business areas: potable, recycled, and sewer.

The District establishes different funds to track revenues allocated to different activities. Once established, each fund receives financial resources up to the levels defined in this policy. Every year, as a part of the annual budget process, the District's rate model is updated for each fund with the current fund balances and the estimated revenues and expenditures for the next six years. The expenditure requirements and financial resources are then evaluated to ensure that the existing fund balances and additional revenues are sufficient within the current budget cycle and for the next five years to maintain target fund levels. If a deficit is identified, then options for transfers, shifting CIP projects, debt, cost saving measures, and/or rate increases are evaluated.

1.2 The District's Capital Improvement Program (CIP)

The planning, design, and construction costs of all capital facilities within the three business segments are allocated to four cost types and corresponding fund categories: New Water Supply, Expansion, Replacement, and/or Betterment. The allocation to these four cost types is defined in the District's Capital Improvement Program (CIP) and is determined by an engineering analysis that identifies which type of customer will benefit from each facility, planned or existing. The costs of the capital improvements are borne by either existing users or by the developing areas, or by a combination of the two, as applicable.

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This Reserve Policy protects both the existing users and the developing areas from incurring unwarranted costs. Developing areas are not required to finance facilities that are replacement or betterment and established areas are not required to replace facilities before they are worn out because of new development. However, to ensure a fair allocation of costs, each facility has the potential to be classified into any or all of the four cost types. In addition to these cost types there are occasional CIPs that may be billable to a third party, if for example a third party requires a District facility be relocated. Paragraphs a through d below, describe how the costs of capital facilities are financed through various fees.

a. New Water Supply
The portion of a new supply project that benefits new users is financed from the reserves in the New Water Supply Fund category. These reserves are primarily derived from proceeds of the new water supply fee. The New Water Supply Fund is restricted, meaning the amounts credited to this fund are accounted for separately and are used solely for the planning, design, and construction of the new water supply expansion facilities. Debt financing may also be a temporary financial resource to finance new water supply projects. The District has a Debt Policy (Policy No. 45) that guides the debt issuance process. Any debt proceeds used for this purpose would be restricted in nature and tracked separately. General use reserves may also be placed in the Designated New Water Supply Fund and used for water supply projects.

b. Expansion
The portion of a CIP project that benefits new users is financed from the reserves in the Expansion Fund category. These reserves are primarily derived from proceeds of the "incremental" portion of the capacity fees collected within developing areas. Capacity fees are accounted for separately and used for the planning, design, and construction of expansion facilities. Additionally, expansion may be financed by annexation fees or the "buy-in" portion of the capacity fee. Both of these fees are restricted for CIP purposes, but not specifically for expansion. Debt financing may also be a temporary financial resource for expansion projects. General use reserves may also be placed in the Designated Expansion Fund and used for expansion projects.

c. Replacement

The portion of a CIP project that benefits existing users by replacing an existing facility is financed from the reserves in the Replacement Fund category. Replacement of facilities may be financed with proceeds of annexation fees, the "buy-in" portion of the capacity fees, general use reserves held in the Designated Replacement Fund and debt proceeds. The various funding sources available for replacement projects is anticipated to provide the necessary flexibility to begin projects while any necessary debt financing is being obtained.

d. Betterment

Facilities that improve reliability, meet new regulations, or create increased levels of service are considered betterment facilities that benefit existing users. The reserves in the Better Fund category are used to finance these projects or portions of projects. Certain user rates, charges, and betterment fees are restricted geographically for betterment of facilities, but may also be used for general maintenance of facilities in that area. Proceeds of the annexation fee and the "buy-in" portion of the capacity fees may also be used to finance betterment projects. General use reserves may be placed in the Designated Betterment Fund and used for betterment projects.

1.21 Relocations

Occasionally, relocation of a District facility is required by a third party. If the District has a superior easement the relocation cost will be paid by the third party, but only to the extent that the District does not benefit from the relocation. When relocation is required, a CIP project may be created which is wholly or partially financed by a third party. On occasion, the District will require that its own facilities be relocated. Depending on the nature of the facilities, the financial resources for these projects could be from new water supply, expansion, replacement, betterment or third party financing. Each project is individually negotiated with the third party based on the facts and circumstances of the relocation. Occasionally, the District will improve the facilities that are being relocated. When determining how to allocate costs to various funds the following guideline is suggested: if a project has more than five years of useful life remaining, an incremental cost view should be considered; if the project has less than five years of useful life remaining, a pro-rata cost approach should be considered. Also, the likelihood the District will benefit from an asset's life extension should be evaluated prior to allocating costs.

1.22 Oversizing
If deemed reasonable by the District, in connection with the construction of backbone facilities, a developer may be required to oversize new facilities for future development. The developer is reimbursed for incremental oversizing costs as per Policy No. 26. These reimbursements are not available for the distribution system within a development which is an obligation of the developer.

1.23 Exclusion of Developed Areas from Expansion Costs
Developed areas are assumed to have sufficient supply and capacity to meet their current requirements as provided by the developers. In addition, they are considered to have borne capital financial costs that are at least proportionate to the benefits they have received from capital facilities. Accordingly, no regional capital financing costs are allocated to these areas so that they will not incur any costs for newly developing areas, except for capital projects that produce district-wide benefit or cost savings.

1.24 Improvement Districts (IDs)
Improvement Districts (IDs) are established to facilitate the financing of particular improvements by the specific beneficiaries. The District has a number of improvement districts that were established for General Obligation (GO) debt repayment. Most GO debt has been paid off and it is unlikely that the District will issue additional GO debt. Improvement districts continue to be used for other purposes: 1) to distinguish sewer customers from water customers on the county tax roll; 2) to place parcels on the county tax roll for the collection of availability fees; or 3) for charging special water rates.

Over the years, the District moved to a district-wide perspective of financing improvements. This philosophy is evident by the district-wide capacity and annexation fees. The District also uses district-wide water rates. As time goes on, it is expected that IDs will continue to outgrow their purpose and their use will diminish.

1.3 The Purpose of the Policy

Public entities accumulate and maintain reserves to ensure both financial stability and continuous availability of services. Financial stability and the resulting improved credit quality allow the public entity to weather times of uncertainty and the impact of negative events, both major and minor. Reserves allow for the ongoing maintenance of property and timely payment of expenses even when such expenses exceed money available from a single fiscal period. In the final analysis, the type and level of reserves are driven by the type and magnitude of uncertainty faced by the public entity.

A "reserve" has a number of meanings, as follows:

- Working capital is required to insure timely payment of obligations.
- A buffer against volatility in revenues.
- Liquidity is required to obtain other goods and services (*e.g.*, bank services).
- Designated money to protect creditors.
- Money set aside to replace assets at the end of their useful lives.
- Money set aside to repair or replace assets damaged or destroyed at unanticipated times.

It is important to note that reserves, fund balance, and net assets are not the same. Fund balance and net assets are accounting terms and may not always be in the form of cash or liquid investments. Fund balances and net assets may not always be reserves unless a designation of all or a portion of fund balance is made. In addition, the term fund balance was replaced by net assets as codified by the Governmental Accounting Standards Board (GASB).

In short, reserves are the liquid assets of the District, accumulated and maintained for application to finance contingent future activities, whether known or unanticipated, operating or capital in nature. The District's Reserve Policy governs the management and use of these financial resources. Few policies have a more significant impact on the financial health and stability of the District. This policy explains several key financial concepts used by the District and provides some background information to the overall strategies and practices utilized. The District has a fiduciary obligation to its customers, to manage and direct the use of public funds for the purpose of providing water and sewer services in an efficient and financially sound manner.

1.4 Policy Guidelines

In 2000, the Little Hoover Commission reviewed the levels of reserve funds for special districts in California and prepared a report reflecting that special districts were accumulating unreasonable levels of funds. As a proactive response, the California Special Districts Association (CSDA) prepared Reserve Guidelines for its members. The Reserve Guidelines were significant in noting that reserve levels need to be in context of the organization's overall business model and capital improvement plan.

There are a number of potential events which the District should consider in the development of reserves:

- Economic Uncertainty - performance of the regional economy and the impact of that performance on demand for water.
- Weather - the amount of rainfall and the impact of weather on the availability and the cost of water as well as the demand for water.
- Government Mandates - the impact of federal and state regulation, particularly environmental regulation.
- Tax Changes - limitations on the District's taxing and spending powers through the passage of a voter referendum, the impound of District property taxes or the removal of the District's power to levy property taxes, further increases to Educational Revenue Augmentation Fund (ERAF) contributions or changes in calculation methodology.
- Operating Costs - increases in operating and maintenance costs because of inflation, labor agreement or other modification.

- Force Majeure - unanticipated expenditures resulting from natural disasters or intentional acts.
- Emergency Maintenance - unanticipated expenditures resulting from unexpected failure of assets (*e.g.*, rupture in the primary transmission system).
- Unexpected Variation in Cash Flow - the incidence of additional costs or decreased revenues that require short-term borrowing in the absence of sufficient financial resources.

The California State Auditor has, in its oversight role, offered a number of quality recommendations for the development of reserve policies as outlined in its report entitled, "California's Independent Water Districts: Reserve Amounts Are Not Always Sufficiently Justified, and Some Expenses and Contract Decisions Are Questionable," dated June 2004, Report No. 2003-137. All of these recommendations have been incorporated into this policy in an effort to address key issues surrounding the management and use of District reserves. The detailed objectives as identified by the State Auditor are as follows:

- Distinguish between restricted and unrestricted reserves.
- Establish distinct purposes for all reserves.
- Set target levels, including minimums and maximums, for the accumulation of reserves.
- Identify the events or conditions that prompt the use of reserves.
- Conform to plans to acquire or build capital assets.
- Receive Board approval and that it is in writing.
- Require periodic review of reserve balances and rationale for maintaining them.

Yet, the State Auditor's report acknowledges that the California Constitution (Article XIII B, Section 5) is vague in its provisions governing the accumulation and use of reserves.[1]

[1] California State Auditor, Bureau of State Audits, "California's Independent Water Districts: Reserve Amounts Are Not Always Sufficiently Justified, and Some Expenses and Contract Decisions Are Questionable," dated June 2004, 2003-137; p. 8.

Specifically, the Constitution states that "each entity of the government can establish contingency, emergency, unemployment, reserve, sinking fund…or similar funds as it shall deem reasonable and proper."[2] Similarly, the State's Water Code does not impose any requirements as to specific or recommended reserve fund levels. As a result, the public finance community as a whole has yet to settle on any real objective standards for the level of reserve funds appropriate for governmental enterprises. This lack of consensus as to specific standards is indicative of the wide variance of the financial and operations context for different districts and different contingencies justifying reserves.

The Government Finance Officers Association (GFOA) in its "Recommended Practice on Appropriate Level of Unreserved Fund Balance in the General Fund" (2002) states that in establishing a policy governing the level of unreserved fund balance in the general fund, a government should consider a variety of factors. These include:

- The predictability of its revenues and the volatility of its expenditures (*i.e.*, higher levels of the unreserved fund balances may be needed if significant revenue sources are subject to unpredictable fluctuations or if operating expenditures are highly volatile).
- The availability of resources in other funds as well as the potential drain upon general fund resources from other funds (*i.e.*, the availability of resources in other funds may reduce the amount of the unreserved fund balance needed in the general fund, just as deficits in other funds may require that a higher level of unreserved fund balance be maintained in the general fund).
- Liquidity (*i.e.*, a disparity between when financial resources actually become available to make payments and the average maturity of related liabilities may require that a higher level of resources be maintained).
- Designations (*i.e.*, governments may wish to maintain higher levels of the unreserved fund balance to compensate for any portion of unreserved fund balance already designated for a specific purpose).

[2] California Constitution, Article XIII B, Section 5.

In the preparation of this policy, each of the CSDA guidelines and the GFOA recommendations has been considered. In addition, all seven objectives provided by the State Auditor are specifically addressed for each reserve. The District wholly supports the State Auditor's efforts to bring a high-level of quality to reserve governance and establishing a standard of performance.

The District recognizes that the customer pays for services provided. Quality management requires that periodic valuations be performed so that fees and charges can be set at appropriate levels to recover the cost of service. The District's Reserve Policy has been drafted with consideration of the GFOA, CSDA, and State Auditor's general guidelines as provided above. In addition, the District has adopted the following principles in the management of its financial resources:

- Reserves are held and used only for the purpose for which they are collected. This is done to maintain equity among customers.
- Each of the service types is tracked separately so that expenditures and revenues can be monitored and evaluated for each customer type. This provides the District with the necessary information to appropriately charge for each of the services.
- Separation of operations and maintenance from capital expenditures occurs within each of the service types. This is done because the financing of these expenditures is often on different timelines or use different reserves.
- The District will hold its reserve at responsible and prudent levels. This policy sets minimum, maximum, and target levels for each of the various funds. This has been done so that the District can maintain reserves to meet the purpose for which the funds were established. The levels are set by reference to line items in the District's financial statements and approved budgets. This allows reserve levels to adjust to the District's changing financial circumstances.
- Debt financing of facilities provides intergenerational equity and maintains rates at reasonable levels. This equity is accomplished with long-term financing which spreads the cost of facilities over the life of the facilities. The burden to pay for facilities is then paid by those who use

them. The District could amass significant reserves by pre-collecting financial resources in a Replacement Reserve Fund allowing the District to cash finance all replacements. However, this would require significant rate increases burdening the current customers and creating reserve levels difficult to defend to the ratepayers or other oversight entities.

These concepts are fundamental to the way the District manages its funds and have a direct impact on the way rates and charges are set. The District performs annual budget evaluations and updates its rate model on an annual basis to monitor and adjust the various funds and revenue sources. The separation, tracking, and projecting of the various funds and expenditures create the essential information necessary for the equitable rate structure maintained by the District. The annual review preserves the balance between services provided and the fees charged. This review also insures that reserves will be available to continue to serve the District's customers.

Financial Sources

2.0 Developers

a. Meter Installation Charges (General Use)
Meter fees are charges collected for new water service connections. Fees vary depending upon meter size and type of service. The costs associated with meter installations are included in the Operating Expenses section of the budget. These charges are financed by developers.

b. Developer Deposits (General Use)
These deposits are for the engineering and operations services provided to developers. They are tracked separately for each developer and any excess amount is returned to the developer.

c. Annexation Fees (Restricted)
Annexation fees[3] are collected as a condition of annexing into the District's potable and recycled water facilities. Since the existing facilities have been built and maintained by developers or customers within the District, the

[3] Code of Ordinances, Section 9.

annexation fee is calculated based on the present value of all property taxes (1% property tax and availability fees) paid by existing and prior customers. The annexation fee insures that future users finance a portion of facilities that were sized, built, and maintained for both existing and future users. Proceeds of annexation fees are restricted and can be used for expansion, replacement, or betterment projects. These reserves may be shifted back and forth as financing needs change.

d. Annexation Fees (Unrestricted)
A sewer annexation fee is collected when property is annexed into an improvement district. This fee is calculated using the "buy-in" basis and therefore is unrestricted.

e. New Water Supply Fee (Restricted)
New water supply fees[4] are based on the cost of the expansion portion of new water supply projects divided by the number of future equivalent dwelling units (EDU). The new water supply fee covers the cost of planning, design, construction, and financing associated with facilities for the District's new supply needs. These fees are paid by developers. The proceeds of this fee may be used only for new potable or recycled water supply projects. Although the fees collected are not restricted separately, one portion for potable and the other for recycled, they are tracked separately.

f. Capacity Fees (Restricted)
Capacity fees[4] are based on the value of existing and future facilities divided by the number of existing and future equivalent dwelling units. This method of calculating capacity fees is called the combined method, where the "buy-in" portion of the capacity fee covers costs to repay existing customers for the facilities that they have built, and where the "incremental" portion of the capacity fee covers the cost of future expansion facilities. The "buy-in" portion of the capacity fee is restricted to pay for planning, design, construction, and financing associated with expansion, replacement or betterment facilities. The "buy-in" portion may be shifted back and forth between expansion, betterment or replacement as the financing needs change. The

[4] Code of Ordinances, Section 28

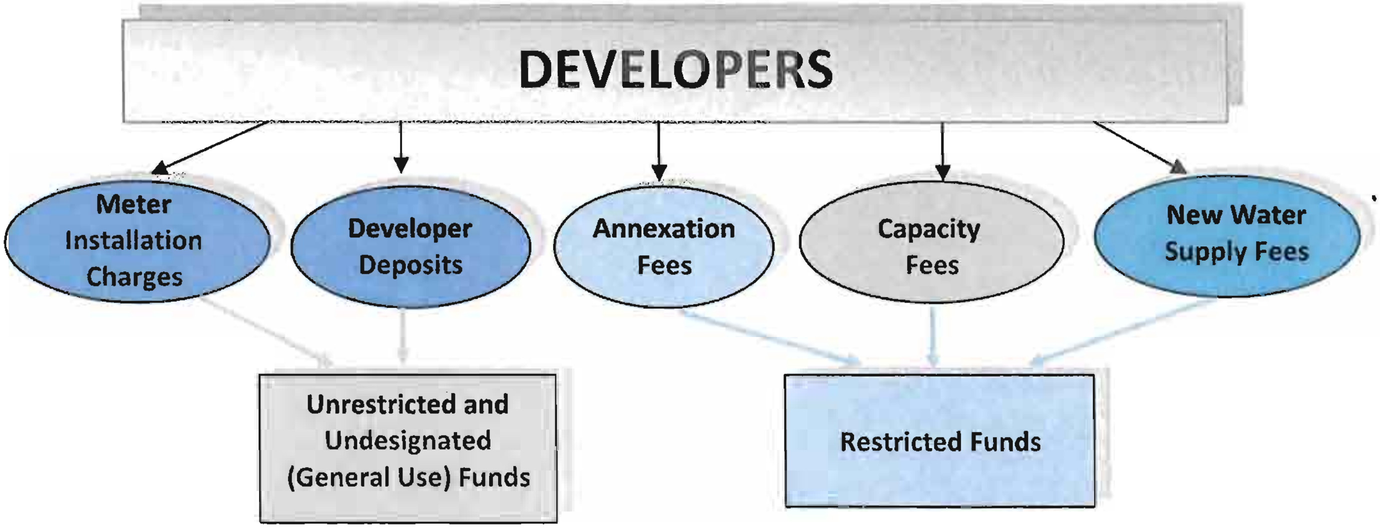
"incremental" portion of the capacity fee is limited to planning, design, construction, and financing exclusively for expansion facilities (excluding new water supply expansion).

Facility needs are based on projected land use planning. Changes in anticipated future land use occur and can alter projected facility requirements. Thus, both the anticipated facilities needs and their projected costs change over time as regulatory agencies make changes to land use. The District periodically reviews the capacity fee calculation to accommodate such variations. These fees are paid by developers.

The District's construction of infrastructure occurs prior to the addition of EDUs. This sequence serves two purposes: one it ensures that the District can serve the pending construction as it is completed; and two, it is more efficient to oversize many facilities at the outset rather than build for the current need and then reconstruct when the future need is realized. As a result of this strategy, the District has financed construction with bond financing as the existing expansion reserves are depleted.

The capacity fee is calculated based on the combined recycled and potable water systems needs. This methodology is used because the two water systems work hand-in-hand. All capacity fees can be used for either potable or recycled but must be tracked to distinguish between the "buy-in" and "incremental" portions as described above. So, while capacity fees are not restricted separately by potable and recycled, they are tracked separately.

Diagram 2.0: Flow of Funds - Developer Sources



2.1 Customers/Users

a. Uniform Rates and Charges (General Use)
Charges to users for water, sewer, and recycled water are uniform throughout the District for similar customer types.

b. Monthly System Fees (General Use)
This is a fixed revenue source that is charged monthly. The amount of the charge is based on the meter size.

c. Energy Charges (General Use)
The energy pumping fee is a charge per unit of water for each 100 feet of lift, or fraction thereof, above the base elevation of 450 feet. This charge is placed on the monthly water bills of all water customers.

d. Penalties (General Use)
Penalties are added to the monthly water and sewer bills for late charges, locks, etc.

e. Pass-through Fixed Charges (General Use)
A fixed monthly charge to the District's customers intended to collect sufficient funds to pass-through the increased

fixed costs from the County Water Authority (CWA) and the Metropolitan Water District (MWD).

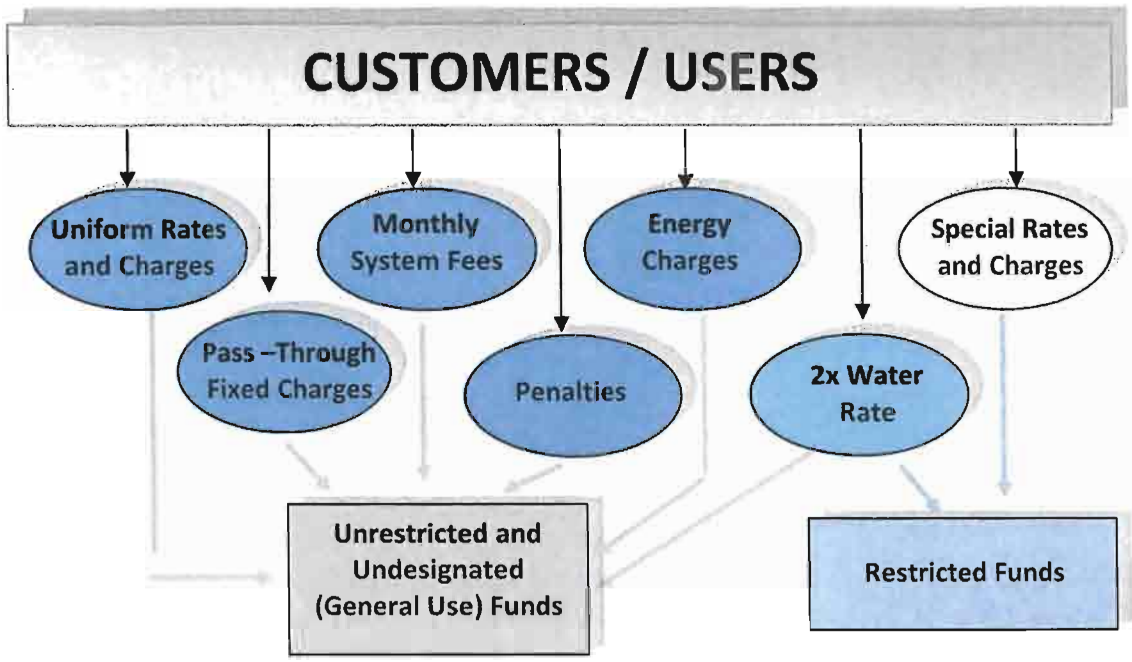
f. Special Rates and Charges (Restricted)
In addition to the uniform water charges, the District currently has five special water rates and one sewer rate. The five water rates are for construction, installation, and maintenance of water storage reservoirs, pump stations, and water lines. Each of these rates and charges must be used within the respective geographic areas from which they are collected. These special charges are listed below:

- North District water charge (Code section 25.03G)
- ID 9 water charge (Code section 25.03H)
- ID 3 water charge (Code section 25.03I)
- ID 10 water charge (Code section 25.03I)
- La Presa water charge (Code section 25.03I)
- Russell Square sewer charge (Code section 53.04C)

When these rates were established they were for the specific purpose of constructing, installing, and maintaining the water and sewer systems in the areas in which the fees were collected. Therefore, these are restricted reserves by geographic area as well as by purpose. These rates and charges can also be used for maintenance; unlike the availability fees (discussed in 2.2 B.). These six special rates and charges along with availability fees are tracked separately, by geographic area, so they can be individually evaluated to maintain the targeted reserve levels. To meet this need, each special rate and charge is accounted for in a "sub-fund" of the Betterment Fund.

g. Temporary Meter Fees (General Use/Restricted)
Water charges, in lieu of capacity fees, are charged on temporary meters. This is done because temporary meters use system capacity but they are not charged a capacity fee. Temporary water use is charged at two times the water rate with the added charge placed in the Restricted Expansion Fund. The primary users of these temporary meters are developers; however, general customers also use these for various purposes.

Diagram 2.1: Flow of Funds - Customer Sources



2.2 County-Collected Taxes and Fees

a. <u>General Levy Property Tax Receipts (1% Property Tax) (General Use)</u>

In 1978, Proposition 13 limited the levy of ad valorem property taxes on real property to one percent of the assessed value of such property. Subsequent legislation, AB 8, established that the receipts from the one percent levy were to be distributed to taxing agencies proportionate to each agency's general levy receipts prior to Proposition 13. Taxes received are for general use.

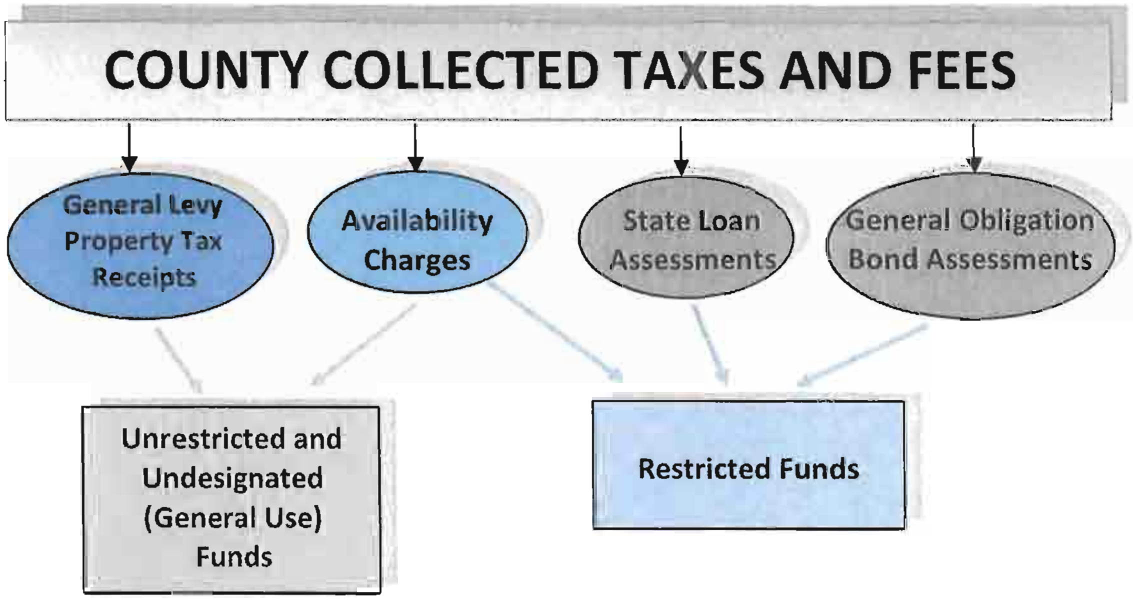
b. <u>Availability Charges (General Use/Restricted)</u>

The District levies availability charges each year in developed and undeveloped areas. Current legislation provides that any amount up to $10 per parcel is general use and any amount over $10 per parcel is restricted to be expended in and for the improvement district (ID) within which it is collected. Accordingly, the District may use availability charges in excess of $10 toward costs of water and sewer facilities which are either, expansion, betterment, or replacement of facilities consistent with the purpose of the ID in which they are collected. This portion of the proceeds of availability charges is geographically restricted and restricted by purpose. As costs are incurred on these projects the respective IDs are charged, reducing the reserves. To the extent that availability charges are not used for the purpose for which they are collected, they must be returned to the property owners that paid them. The District has historically used these reserves for betterment capital facilities thus, the restricted reserves are accounted for in "sub-funds" of the Betterment Fund (see 2.1 f.).

c. <u>State Loan Assessment (Restricted)</u>
The District assesses a charge per unit of sewer service each year on the sewer customers. This is collected via the county tax roll and is specifically collected for the repayment of the state loan. When this loan is paid off the charge will be removed.

d. <u>Improvement District General Obligation (GO) Bond Assessments (Restricted)</u>
The District has historically issued general obligation (GO) debt and establishes an improvement district for the repayment of that debt. When this financing method is used, the county tax roll can be used to collect special taxes or assessments within the ID to pay the debt obligation. The proceeds of the debt are restricted for the purpose as defined in the bond documents.

Diagram 2.2: Flow of Funds – County Collection Sources



2.3 Miscellaneous Income

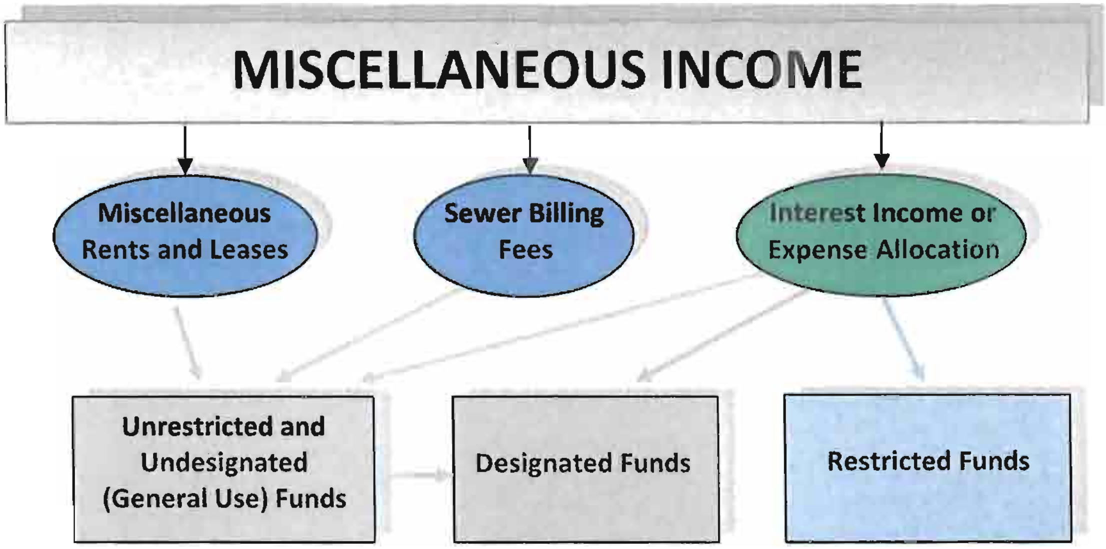
a. <u>Miscellaneous Rents and Leases (General Use)</u>
Revenues received from the rental and lease of District property are general use revenues. Not only are they periodic revenues, but there is also a one-time fee charged with the setup of each new lease. The District incurs expenses related to these rents and leases. The one-time fees are calculated to recover the costs to setup the leases.

b. <u>Sewer Billing Fees (General Use)</u>
Sewer billing fees are general use revenues. The District provides processing and billing services to the City of Chula Vista to bill and collect from their customers for sewer service. These fees are to recover the cost the District incurs to provide this service.

c. <u>Interest Income or Expense Allocation (General Use, Designated, and Restricted)</u>
Interest income (expense) will be allocated every month based upon each fund's month-ending balance. In this way, each fund receives credit for interest earned by that fund and

each fund with a negative balance is charged for the use of the other fund's reserves.

Diagram 2.3: Flow of Funds – Miscellaneous Income Sources



2.4 Debt Issuance

a. Loans (General/Restricted Use)

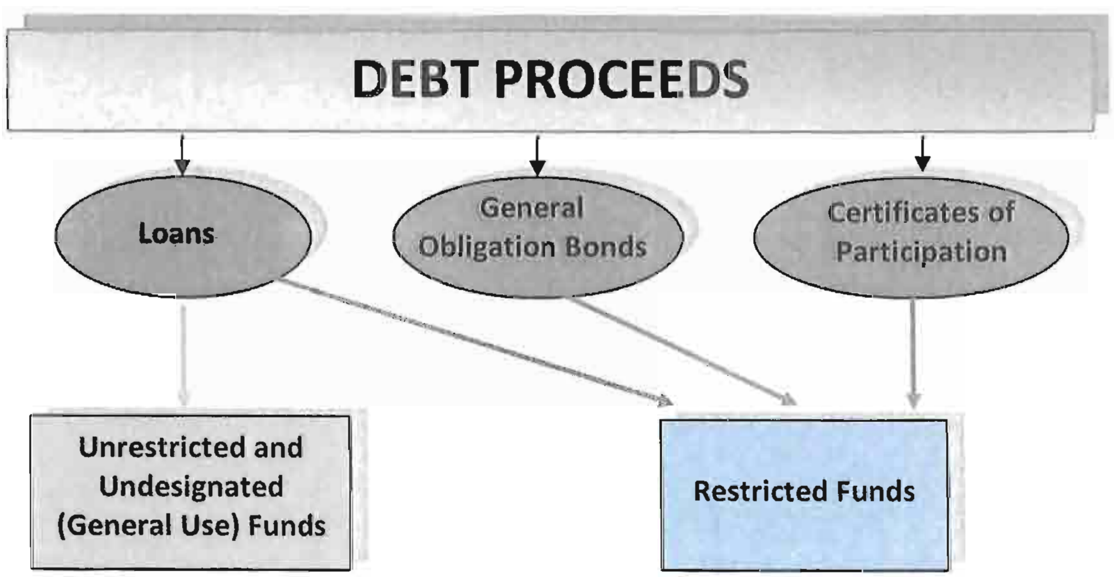
As the District determines that additional financing is required for a particular purpose, the option of borrowing is considered. The determination to borrow is made as a part of the annual rate model update and is evaluated in accordance with the Debt Policy before it is recommended to the Board for action. As an option to bond indebtedness, loans are available to satisfy short-term financing needs. These loans may or may not be contractually restricted for a particular purpose.

b. General Obligation (GO) Bonds (Restricted)

As the District becomes more developed it becomes less likely that general obligation debt will be used as it requires a vote of the public to be approved. Bond proceeds are restricted for the construction of those facilities identified in the GO bond issuance. Occasionally, specific portions of bond proceeds may be allocated for the repayment of the principal and interest, also called debt service, on these bonds. As the District determines that additional financing is required for a particular purpose, the option of debt issuance is considered. The determination to issue debt is made as a part of the annual rate model update and is evaluated in accordance with the Debt Policy before it is recommended to the Board for action.

c. Certificates of Participation (COPs) (Restricted)
General revenues of the District are pledged as security for Certificates of Participation (COPs) indebtedness. If the District determines that additional financing is required for a particular purpose, the option of debt issuance is considered. The determination to issue debt is made as a part of the annual rate model update and is evaluated in accordance with the Debt Policy before it is recommended to the Board for action. This form of financing has become the industry's preferred form of financing as it does not require a vote of the general public.

Diagram 2.4: Flow of Funds – Debt Issuance Sources



2.5 Inter-fund Transfers

Each year in the budgeting process, future fund levels are projected for the next six years. Based on these projections transfers are recommended. Reserves may be transferred between Unrestricted or Designated Funds and the General Fund (see 4.0 "Funding Levels" and 4.1 "Fund Transfers"). Reserves may not be transferred to or from any of the restricted funds unless it is between two restricted funds with a shared purpose.

Fund Types and Categories

3.0 General Funds

a. Purpose

The General Fund is neither restricted nor designated. The District maintains one General Fund for each business segment (water, sewer, and recycled). This fund holds the working capital and emergency operating reserves. While the General Fund has a short-term focus to finance the District's annual operations, it is supported by the six-year rate model. This fund is primarily used to finance the operations of the District; however, it can be used for any District purpose.

This fund can be used to supplement the District's rates and charges and be a temporary source of revenue to balance the Operating Budget. This fund can also be used to avoid spikes in the rates or significant and abrupt increases. It is an industry practice to have a fund that can be used to stabilize rates. This would only occur if there was a temporary need for reserves that would smooth out a rate spike or to ramp up what would otherwise be a dramatic rate increase.

The General Fund also plays a role in the debt planning of the District. This fund is viewed by the debt markets as a commitment by the District to ensure financial stability of the rates and charges of the District. The District is anticipated to need a number of debt issuances over the years and this fund will help the District not only to stabilize rate fluctuations but also to access low cost financing for future projects.

b. Sources

Meter installation charges, temporary meter fees, uniform rates and charges, monthly system fees, energy charges, penalties, pass-through fixed charges, general levy property tax receipts, availability charges, miscellaneous rents and leases, sewer billing fees, interest income or expense allocation, loans, and a portion of the temporary water sales.

The sewer general fund receives sewer charges, penalties, availability charges, sewer annexation fees (calculated on the "buy-in" basis), and interest income or expense allocation.

c. Funding Levels

I. **Minimum Level** - The minimum reserve level for each business segment of the General Fund is three months of operating budget expenses (evaluated separately for each segment).

II. **Maximum Level** - The maximum reserve level for the General Fund is nine months of operating budget expenses. In the event that this fund exceeds the seven month level, the excess will be evaluated or transferred to one or more of the designated funds.

III. **Target Level** - The target level of reserves is three months of operating budget expenses. In the event that the fund drops below the target level, rate increases or fund transfers would be considered.

3.1 Designated Other Post Employment Benefits (OPEB) Fund

a. Purpose

Designated Other Post Employment Benefits (OPEB) reserves are "general use" reserves that have been set apart by Board action to finance the medical benefits of qualified retirees as outlined in the District's benefits plan. This District fund holds only a portion of the total OPEB reserves. The other portion is held in a trust at CalPERS and is restricted for the purpose of financing the OPEB liability. The two portions are considered jointly when looking at target reserve levels. Every two years, the fund is evaluated by an actuary to update the annual financing requirements. Changes in the actuarial valuation may result from changes in benefit levels, employee population, health insurance costs, or general market conditions. The reserves held by the District are currently designated and may be placed into the CalPERS trust to legally restrict the funds, removing the District's legal access to these reserves.

b. Sources

The OPEB liability may be financed by general use reserves coming from user rates and charges, either from an operating budget expenditure or from interfund transfers. Transfers of unrestricted reserves may come from the various designated funds or from the General Fund. As a part of the normal budget process, annual operating revenues have been sufficient to finance the ongoing needs of this designated fund. While debt financing is also an option, the District has only used user rates and charges to finance this fund.

c. Funding Levels

I. **Minimum Level** - The minimum reserve level for this fund is equal to the District's OPEB liability as determined by the actuarial study. When considering the reserve level of this fund, both the District held OPEB reserves and CalPERS held OPEB reserves must be considered jointly.

II. **Maximum Level** - The maximum reserve level for this fund is equal to the District's OPEB liability as determined by the actuarial study. In the event that the two funds, as described above, exceed the OPEB liability, the District will reduce the annual funding levels as defined by the actuarial study.

III. **Target Level** - The target reserve level for this fund is equal to the District's OPEB liability as determined by the actuarial study. In the event that the two funds, as described above, fall below the OPEB liability, the District will increase the annual funding levels as defined by the actuarial study.

3.2 New Water Supply Fund Category

a. Purpose

The New Water Supply Fund category is to finance the expansion portion of new water supply projects and is therefore to be paid by developers. When considering the reserve level of the New Water Supply category; the New Water Supply Fund, the New Water Supply Debt Fund, and the Designated New Water Supply Fund all work in concert and must be considered jointly.

b. Sources

The New Water Supply Fund receives reserves only from the new water supply fee. Other funds within the new water supply category of funds receive debt proceeds and general use reserves through a designation to this category.

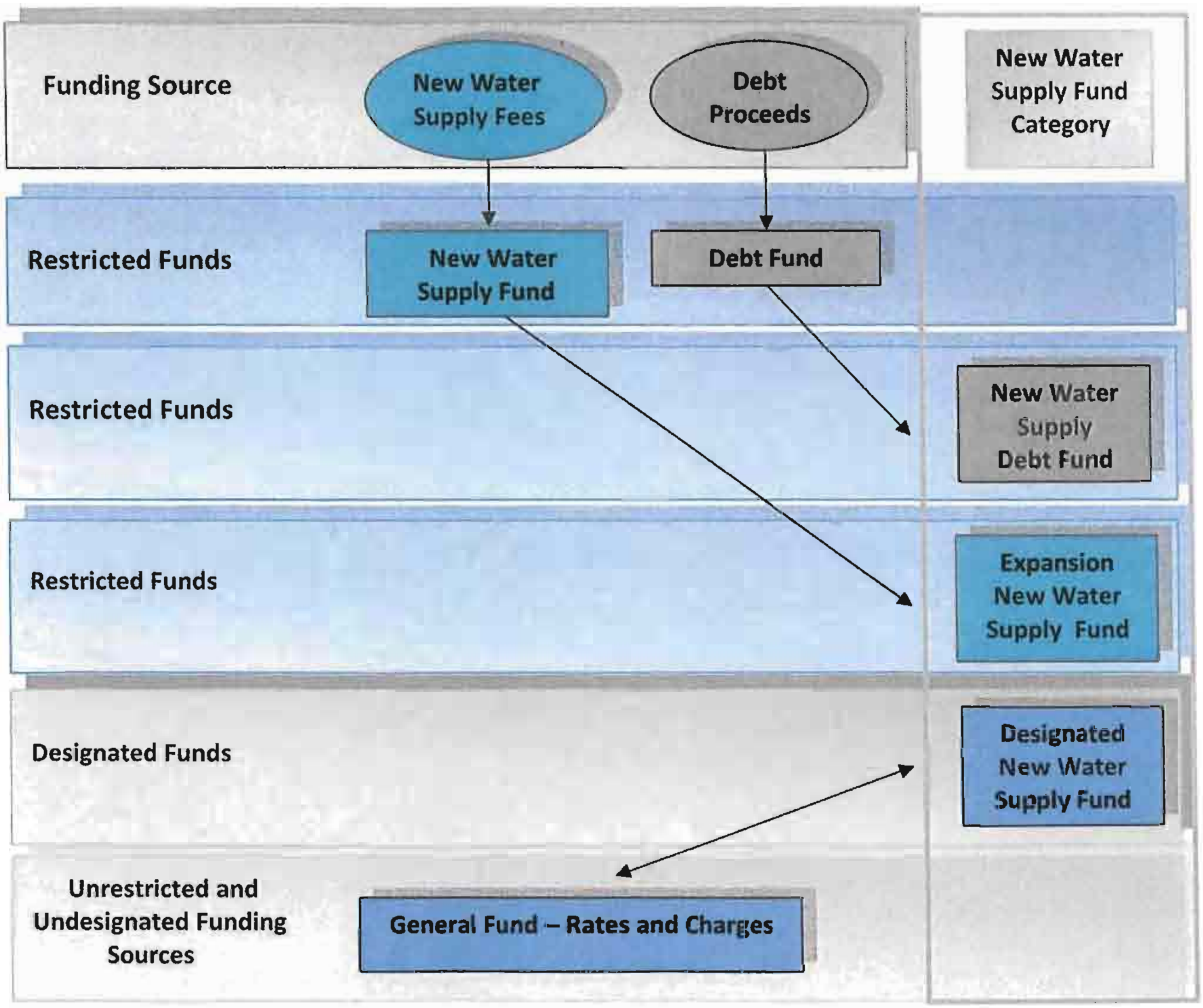
c. Funding Levels

I. **Minimum Level** - As the District matures the CIP will move to purely replacement projects. As the District moves through its lifecycle the need for new water supply reserves will decrease and may be reduced to zero.

II. **Maximum Level** - The maximum reserve level for the new water supply category of funds is limited to five years of the unfinanced new water supply facilities as described in the District's CIP Budget. To determine the unfinanced amount, the total new water supply financing needs must be reduced by the projected new water supply revenues, general fund designations, and bond financing. If the combined new water supply reserves exceed the target level, the District should consider transferring designated reserves to meet other purposes, reduce the new water supply fee, or change the timing of the new water supply projects.

III. **Target Level** - In order to facilitate debt financing of the new water supply, it is important that the various new water supply funds retain an overall reserve level of six months, prior to any attempt to obtain debt financing. This reserve level allows the District the time necessary to issue additional debt without depleting new water supply reserves. If the combined new water supply reserve levels drop below six months of expenditures, this would trigger a transfer of general use reserves, a bond sale, or a change in the timing of new water supply projects. Bond proceeds would be placed in the Restricted New Water Supply Debt Fund while transfers would be placed in the Designated New Water Supply Fund.

Diagram 3.2: New Water Supply Fund Category



3.3 Expansion Fund Category

a. Purpose

The Expansion Fund category is to finance the expansion portion of capital projects and therefore is to be paid for by developers. When considering the reserve levels of the expansion category, the following funds work in concert and must be considered jointly: the Expansion Fund, Expansion Debt Fund, Annexation Fund (potable and recycled only), Capital Improvement Fund, and the Designated Expansion Fund. Potable and recycled reserves are considered jointly while sewer is evaluated separately.

b. Sources

The Expansion Fund is financed by water charges in lieu of capacity fees (for temporary meters) and the "incremental" portion of the capacity fee. The other funds in this category may also be financed by debt proceeds, annexation fees, the "buy-in" portion of the capacity fee, and the general fund through a designation of reserves.

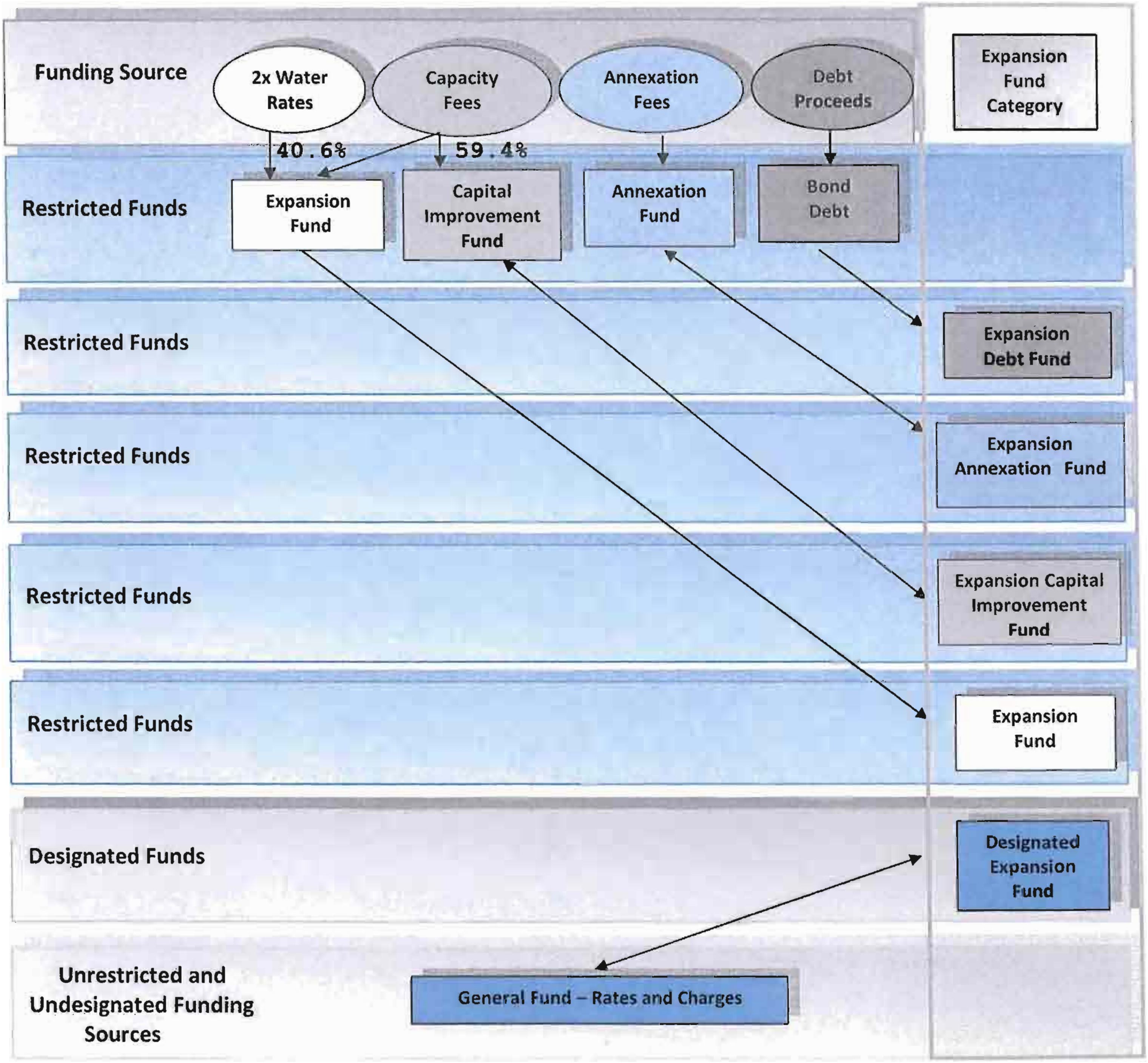
c. Funding Levels

I. **Minimum Level** - As the District matures the CIP will move to purely replacement and betterment projects. As the District moves through this lifecycle the need for expansion reserves will decrease and may be reduced to zero.

II. **Maximum Level** - The maximum reserve level for the expansion category of funds is limited to five years of unfinanced expansion facilities as described in the District's CIP Budget. To determine the unfinanced amount, the total financing needs must be reduced by the projected expansion revenues, bond financing, and any restricted or general fund revenues allocated to this fund category. If the combined expansion reserves exceed target levels, the District should consider reducing capacity fees, reallocating restricted or designated funds to meet other purposes, or shifting the timing of expansion projects.

III. Target Level - The target level is six months of expansion expenditures. It is important that the expansion reserves remain at a minimum of six months of expansion expenditures. This reserve level allows the District the time necessary to issue additional debt without depleting expansion reserves. If the combined expansion reserves drop below six months of expenditures this would trigger a transfer of general use reserves, a bond sale, an adjustment to the timing of expansion projects, or a reallocation of restricted reserves. Bond proceeds would be placed in the Restricted Bond Fund, transfers of general use reserves would be placed in the Designated Expansion Fund, and transfers of restricted reserves would be placed in either the Expansion Annexation Fund or the Expansion Capital Improvement Fund.

Diagram 3.3: Expansion Fund Category



3.4 Replacement Fund Category

a. Purpose

The Replacement Fund category is to finance replacement projects. When considering the reserve levels of the replacement category of funds, the following funds work in concert and must be considered jointly: the Annexation Fund, Debt Fund, Capital Improvement Fund, and the Designated Replacement Fund. The purpose of these reserves is to pay for the replacement of capital infrastructure and capital purchases. These reserves are not to be used for the replacement of non-capital items.

With the District's development of its financial systems and the greater need and ability to separate and track reserves, the replacement reserves have been separated into three funds: water, recycled, and sewer.

Projects undertaken solely for the purpose of replacing major capital equipment or facilities, *i.e.*, where the cost exceeds $10,000 for capital purchases or $20,000 for infrastructure items, generally these are not considered normal maintenance. When the cost is below $10,000, the costs are financed annually as operational maintenance. As charges are incurred on replacement projects the reserves are deducted from the respective Replacement Funds on a monthly basis.

b. Sources

The various funds in this category are financed by debt proceeds, annexation fees, the "buy-in" portion of the capacity fee, and general fund designations.

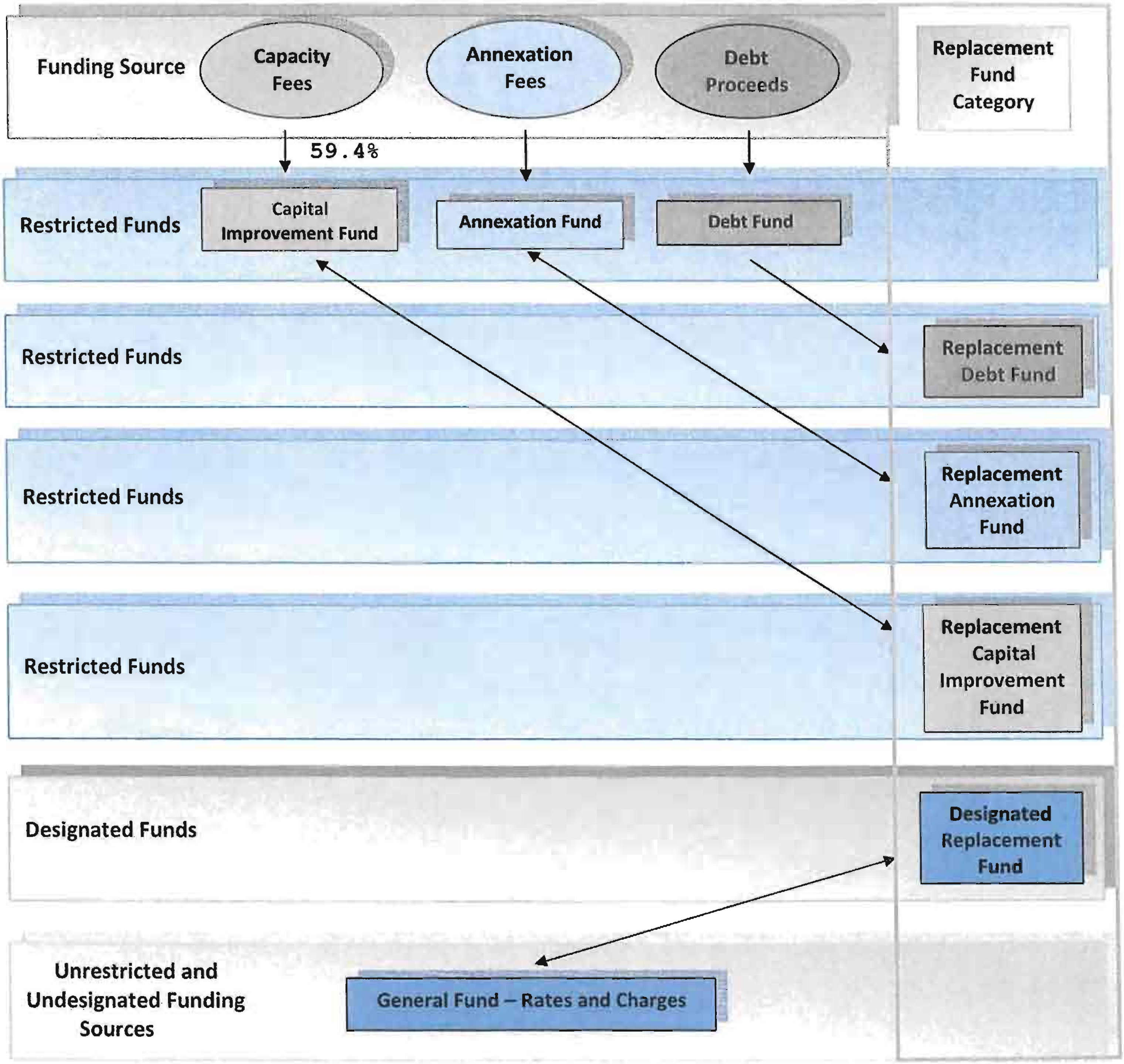
c. Funding Levels

I. **Minimum Level** - The minimum reserve level of this category of funds is 3% of the historical value of existing assets as identified in the District's current financial statements. Potable, recycled, and sewer replacement are evaluated separately.

II. **Maximum Level** - The maximum reserve level of this category of funds is 6% of existing assets. If the combined replacement reserves exceed target levels, the District should consider transferring annexation fees or the "buy-in" portion of the capacity fee to meet other purposes. Another consideration would be to shift the timing of replacement projects.

III. **Target Level** - The target reserve level of this category of funds is 4% of existing assets. In the event that the reserves fall below the recommended target level, the District should consider transferring annexation fees or the "buy-in" portion of the capacity fee. The District should also consider shifting the timing of replacement projects or issuing debt to support the planned level of facility replacement. The District will act based on the annual six-year rate model, to insure that at the end of that planning horizon the reserves exceed the minimum level and is approaching the target level.

Diagram 3.4: Replacement Fund Category



3.5 Betterment Fund Category

a. Purpose

The Betterment Fund category is to finance the betterment portion of capital projects with a portion going to maintenance of the potable, recycled, and sewer systems. The District maintains separate Better Fund categories, one for each improvement district. An improvement district is a legally defined geographic area usually established for the purpose of bond financing of facilities. The betterment reserves within these funds are restricted by law for use within the improvement district in which the fees were collected (Water Code 71631.6). However, the legal restriction of this reserve depends upon the particular revenue source. (See Section 2.1 f. for a review of the special rates and availability fees).

When considering the reserve levels of the betterment category of funds, the following funds work in concert and must be considered jointly: the Betterment Fund, Annexation Fund, Debt Fund, Capital Improvement Fund, and Designated Betterment Fund.

b. Sources

The Betterment Fund category receives restricted revenues by improvement district via special water rates and from availability fees collected through the county tax roll. Betterment may also be financed by debt proceeds, annexation fees, the "buy-in" portion of the capacity fee, as well as the general fund through a designation of reserves.

c. Funding Levels

I. **Minimum Level** - As the District matures the CIP will move to purely replacement projects. As the District moves through this lifecycle the need for betterment reserves will decrease and may be reduced to zero.

II. **Maximum Level** - The maximum reserve level for the betterment category of funds is limited to five years of unfinanced betterment facilities as described in the District's CIP Budget. To determine the unfinanced amount, the total financing need must be reduced by the projected betterment revenues, bond financing, annexation, and general fund designations. If this maximum is exceeded, then the District should evaluate reductions in the special water rates and availability fees, transferring designated reserves to meet other purposes, or shifting the timing of betterment projects.

III. **Target Level** - The target is six months of betterment expenditures. It is important that the betterment reserves remain at a minimum of six months of betterment expenditures. This reserve level allows the District the time necessary to issue additional debt without depleting betterment reserves. If the combined betterment reserves drop below six months of expenditures this would trigger a transfer of general use reserves, a bond sale, or an adjustment to the timing of betterment projects. Bond proceeds would be placed in the Betterment Bond Fund while transfers would be placed in the Designated Betterment Fund.

Diagram 3.5: Betterment Fund Category

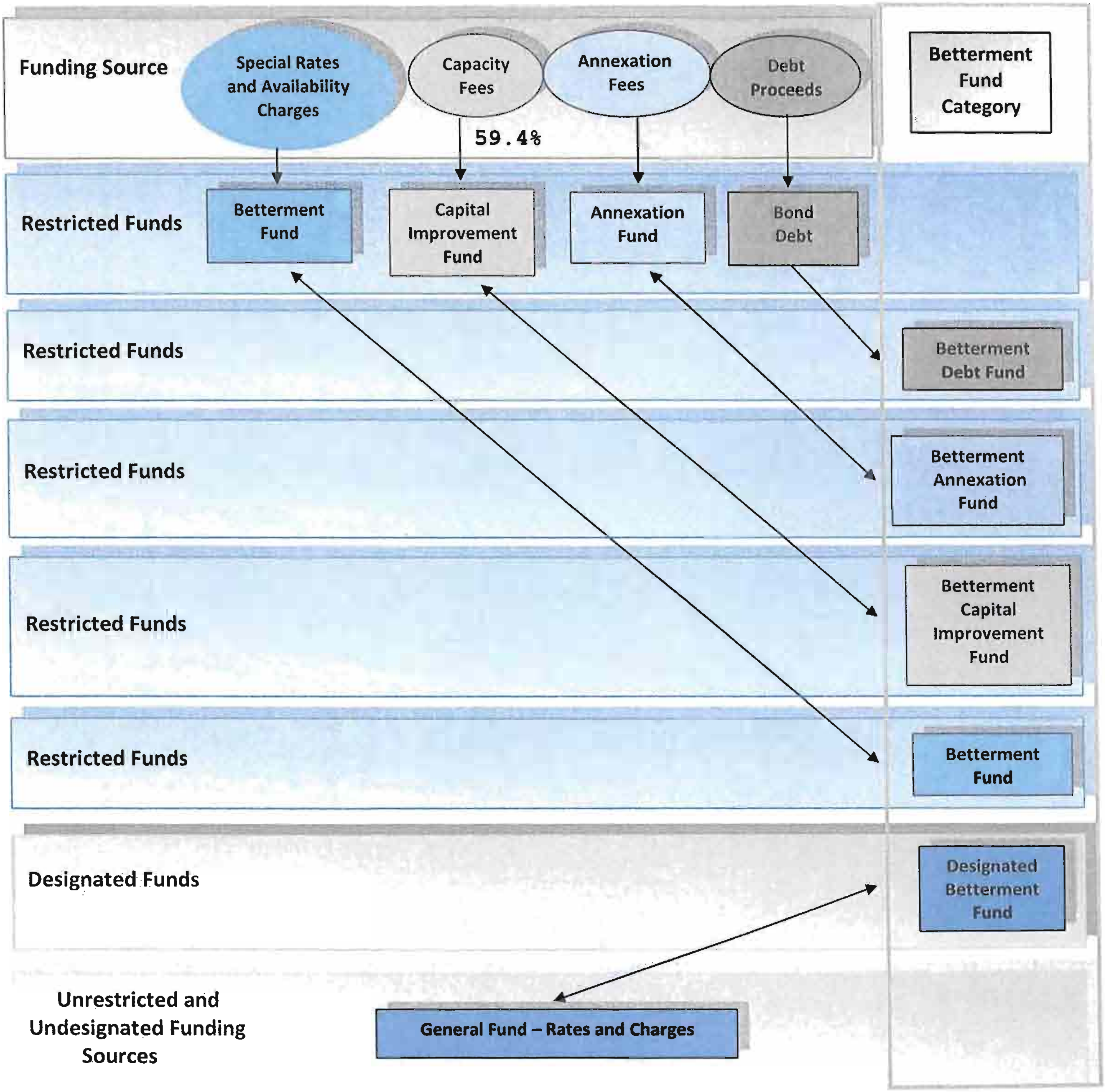


Diagram 3.6: Fund Targets

Fund or Fund Category	Actions to Consider if below Target	Target	Maximum
New Supply Fund Category	New supply fee increase, bond financing, or transfer to designation or to CIF or Annexation Fund	Total of all funds in fund category = six months of capital expenditures	Nexus of cost to fee
Expansion Fund Category	Capacity fee increase, bond financing, or transfer to designation or to CIF or Annexation Fund	Total of all funds in fund category = six months of capital expenditures	Nexus of cost to fee
Replacement Fund Category	Bond financing, or transfer to designation or to CIF or Annexation Fund	Total of all funds in fund category = 4% of infrastructure	Nexus of cost to fee
Betterment Fund Category	Bond financing, or transfer to designation or to CIF or Annexation Fund	Total of all funds in fund category = six months of capital expenditures	5 years unfunded needs
Debt Reserve Fund	Increase tax collection or rates	One semi-annual payment	Two semi-annual payments
OPEB Fund	Fund transfers	Full funding	Full funding
General Fund	Rate increase or fund transfers	Three months of operating budget expenses	Nine months of operating budget expenses

Note: The annexation fee for sewer is a general fund revenue.

Additional Restricted Funds

4.0 Capital Improvement Fund

a. Purpose

The "Capital Improvement Fund's sole purpose is to track the "buy-in" portion of the capacity fee and to ensure these fees are expended solely for the purpose for which they were collected. In this case it is to pay for facilities that were in existence at the time this fee was established. These fees may be used for expansion, replacement, or betterment projects or any debt related to these categories. These fees may also be used for either the potable or the recycled systems. As capacity fees are collected, the "buy-in" portion of the fee is allocated as needed to one of three capital improvement funds, one in each of the Expansion, Replacement, and Betterment Fund categories. These reserves are used to pay debt or offset any negative balance within these three categories of funds. These fees may not be used to finance the New Water Supply category, as there were no new water supply facilities in existence at the time the new methodology for capacity fees was established.

b. Sources

The "buy-in" portion of the capacity fee collected after June 30, 2010.

c. Funding Levels

There are no minimums, maximums, or target levels for these reserves on an individual basis. The allocation of this fee to the various capital improvement funds is dependent on the overall reserve levels within each fund category.

4.1 Annexation Fund

a. Purpose

The Annexation Fund's sole purpose is to track the potable and recycled annexation fees collected and to ensure these fees are expended solely for the purpose for which they were collected. The annexation fees may be used for expansion, replacement, or betterment projects or any debt related to these categories. These fees may be used for either the potable or recycled systems. These reserves may not be used to finance the New Water Supply category, as it was not in existence at the time the fee was established. As these fees are collected they are allocated as needed to one of three capital improvement funds, one in each of the Expansion, Replacement, and Better Fund categories.

b. Sources

Potable and recycled annexation fees collected after June 30, 2010.

c. Uses
There are no minimums, maximums, or target levels for these reserves on an individual basis. The allocation of this fee to the various Annexation Funds is dependent on the overall reserve levels within each fund category.

4.2 Debt Reserve Fund

a. Purpose
The Debt Reserve Fund is established to hold the proceeds from the various debt issuances. There are two types of debt, General Obligation bonds and Certificates of Participation bonds. The proceeds are transferred to the New Water Supply, Expansion, Replacement, or Betterment Debt Funds as they are expended for various facilities within those fund categories. As repayment of the debt occurs, the balances within these individual funds are reduced so that the financial impact of issuing debt is tracked within the category for which the debt was issued.

b. Sources
Debt proceeds.

c. Uses
There are no minimums, maximums, or target levels for this fund on an individual basis. This fund is available on an as needed basis to fund CIP projects for new water supply, expansion, replacement, or betterment. From a funding level perspective, these reserves are evaluated in the context of all the various funds within each fund category.

Fund Transfers

5.0 Funding Levels

As described in the preceding sections, the District maintains reserves for its operating and capital activities. These reserves can be of three types: 1) undesignated or general use reserves, 2) designated, and 3) restricted for a specific purpose. The restricted reserves can be restricted geographically and/or by purpose. The District maintains various funds to track the various designations and restrictions. The source of the money for each fund was discussed along with the purpose, source of funds, and levels. Key characteristics of these funds are the target levels, minimums, and maximums. The funding levels must be viewed in the context of the economic environment, political environment, and in light of the District's rate model. The District's six-year rate model not only shows the current balance but also shows the trend of the fund balances. Often the trend of the fund is a greater indicator of financial stability than is the current balance.

The rate model is updated each year with the budget process and evaluates each fund over the next six years. The rate model will take into account the general economic environment, looking at the development rate, supply rate increases, the possibility of raising rates, capital infrastructure spending, and strategic plan initiatives. The fund balances may at times be over or under the target amount. This is not only acceptable but expected. The rate model provides an empirical estimate of the conformance between the projected District's financial activities and the guidelines of this policy.

5.1 Fund Transfers

Reserves within the District's various designated funds come from interfund transfers of unrestricted general use reserves. It is important to note that the District has the ability to use general use reserves for any business purpose. General use reserves may be transferred to and from any unrestricted fund for any business need. Designated reserves are general use reserves which have been set aside for a specific purpose by Board action. These reserves can only be used for the purpose they were designated, or with Board action they may be used for any other business purpose. While general use reserves may be used for any restricted purpose they may not be transferred to Restricted Funds due to the sensitivity of the tracking of restricted reserves. If reserves are needed for a restricted purpose they are transferred to a Designated Fund within the fund category with that particular purpose. Reserves restricted to a fund category may only be used within that category and may not be transferred to another category. For example, the new water supply fee and the "incremental" portion of the capacity fee are restricted reserves for a specific purpose, and may not be transferred to another category as no other category has the same purpose. However, the "buy-in" portion of the capacity fees and annexation fees are restricted for purposes that are shared by more than one category of funds and may therefore be transferred to a restricted fund within another fund category as long as it shares the same purpose.

In many situations reserve transfers are expected as some fund categories will exceed their maximums or drop below their minimums. Only fund categories that are below the stated target are eligible to receive transferred reserves. Fund categories that exceed their maximums are first to be considered for transfers out, followed by funds that exceed their targets. Funds that exceed their minimums are also available for reserve transfers out, but only when other options are not available.

The rationale for prioritizing reserve transfers is based on the immediacy of the need and the availability of reserves from other funding sources. For example, the General Fund is first to receive reserves when it drops below its target or minimum levels. This is because of the immediate and ongoing nature of the expenditures that are served by this fund. The operation of the District is first and foremost of the objectives of the District. On the other end of the spectrum, the Replacement Fund has a long-term perspective and will be used to partially finance replacement assets for many years to come. Debt financing is available to respond to this long term, foreseeable, and planned cash flow. This fund is less likely to have immediate needs and has other financing options.

When making the determination of when transfers are necessary, all funds within a fund category work as a group. The combined balance of the restricted and designated funds is looked at when determining whether the fund category requires additional funding from the Restricted Capital Improvement Fund, Restricted Annexation Fund, Restricted Debt Fund, or the General Fund. Because the Capital Improvement Fund and Annexation Fund may finance expansion, replacement or betterment reserves may be transferred between these fund categories, but only back and forth within its own type of restricted fund.

As an example, if during the rate model update process it was determined that the Expansion Funds (designated and restricted) would drop and stay below the minimum during the six-year planning horizon, this would trigger a bond sale, a transfer of general use reserves, and/or a transfer of restricted reserves. If in the cash planning process, it was anticipated that the General Fund would remain above target during the planning horizon and that the trend did not present a problematic underfunded status, then General Fund reserves would be considered available for transfer prior to making proceeds available from a bond sale. Also, if during this period the Betterment Fund category was anticipated to exceed its maximum, then reserves from either the Designated Betterment Fund, the Annexation Fund, or the Capital Improvement Fund would be transferred to the corresponding Expansion Fund prior to a bond sale. All funds are evaluated to determine which has the greatest need or availability of reserves before any reserve transfer recommendation is presented to the Board.

GLOSSARY

The Reserve Policy contains terminology that is unique to public finance and budgeting. The following glossary provides assistance in understanding these terms.

Annexation Fees: When water service is requested for land outside the boundaries of the District, the land to be serviced must first be annexed. For sewer service the land must be annexed into an improvement district within the District.

Assets: Resources owned or held by Otay Water District that has monetary value.

Availability Fees: The District levies charges each year in developed areas to be used for upgrades, betterment, or replacement and in undeveloped areas to provide a source of funding for planning, mapping, and preliminary design of facilities to meet future development. Current legislation provides that any availability charge in excess of $10.00 per acre shall be used only for the purpose of the improvement district for which it was assessed.

Betterment Fees: In addition to other applicable water rates and charges, water customers pay a fee based on water service zone or Improvement District. These fees are restricted for use in the area where they are collected and may be used for the construction and maintenance of facilities.

Bond: A written promise to pay a sum of money on a specific date at a specified interest rate. The interest payments and the repayment of the principal are authorized in a District bond resolution. The most common types of bonds are General Obligation (GO) bonds and Certificates of Participation (COPs). These are frequently used for construction of large capital projects such as buildings, reservoirs, pipelines and pump stations.

Capital Equipment: Fixed assets such as vehicles, marine equipment, computers, furniture, technical instruments, etc. which have a life expectancy of more than two years and a value over $10,000.

Capital Improvement Program: A long-range plan of the District for the construction, rehabilitation and modernization of the District-owned and operated infrastructure.

CWA: The County Water Authority was organized in 1944 under the State County Water Authority Act for the primary purpose of importing Colorado River water to augment the local water supplies of the Authority's member agencies. The Authority purchases water from the Metropolitan Water District of Southern California (MWD) which imports water from the Colorado River and the State Water Project.

Debt Service: The District's obligation to pay the principal and interest of bonds and other debt instruments according to a predetermined payment schedule.

Expenditures/Expenses: These terms refer to the outflow of funds paid or to be paid for an asset, goods, or services obtained regardless of when actually paid for. (Note: An encumbrance is not an expenditure). An encumbrance reserves funds to be expended in a future period.

Fund: An account used to track the collection and use of monies for a specifically defined purpose.

Fund Balance: The current funds on hand resulting from the historical collection and use of monies. The difference between assets and liabilities reported in the District's Operating Fund plus residual equities or balances and changes therein, from the results of operations.

Interest Income: Earnings from the investment portfolio. Per District Policy Number 25, interest income will be allocated to the various funds each month based upon each fund's prior month-ending balance.

Late Charges/Penalties: Charges and penalties are imposed on customer accounts for late payments, returned checks, and related telephone contacts.

1% Property Tax: In 1978, Proposition 13 limited general levy property tax rates for all taxing authorities to a total rate of 1% of full cash value. Subsequent legislation, AB 8, established that the receipts from the 1% levy were to be distributed to taxing agencies according to approximately the same proportions received prior to Proposition 13. Funds received are to be used for facilities construction or debt service on bonds sold to build facilities.

Operating Budget: The portion of the budget that pertains to daily operations that provide basic governmental services. The operating budget contains appropriations for such expenditures as personnel, supplies, utilities, materials, travel and fuel, and does not include purchases of major capital plant or equipment which is budgeted for separately in the Capital Budget. The Operating Budget also identifies planned non-operating revenues and expenses.

Revenue: Monies that the District receives as income. It includes such items as water sales and sewer fees. Estimated revenues are those expected to be collected during the fiscal year.

System Fees: Each water service customer pays a monthly system charge for water system replacement, maintenance, and operation expenses. The charge is based on the size of the meter and class of service.

Taxes: California Water Code Section 72091 authorizes the District, as a municipal water district, to levy ad valorem property taxes which are equal to the amount required to make annual payments for principal and interest on General Obligation bonds approved by the voters prior to July 1, 1978.

Water Rates: Rates vary among classes of service and are measured in units. The water rates for residential customers are based on an accelerated block structure. As more units are consumed, a higher unit rate is charged. All non-residential customers are charged a flat rate per unit. A unit of water is 100 cubic feet or 748 gallons of water.

AGENDA ITEM 5

OTAY WATER DISTRICT — ESTABLISHED 1956

STAFF REPORT

TYPE MEETING:	Regular Board	MEETING DATE:	November 3, 2010
SUBMITTED BY:	James Cudlip, Finance Manager	W.O./G.F. NO:	DIV. NO. All
APPROVED BY: (Chief)	Joseph R. Beachem, Chief Financial Officer		
APPROVED BY: (Asst. GM):	German Alvarez, Assistant General Manager, Finance and Administration		
SUBJECT:	Rate Adjustment for Mexico Agreement to Transfer Water		

GENERAL MANAGER'S RECOMMENDATION:

That the Board authorize the General Manager to adjust the wheeling rate for the delivery of Treaty Water to the City of Tijuana to $68.45 per acre-foot for Calendar Year 2011.

COMMITTEE ACTION:

See Attachment A.

BACKGROUND:

The District's contract to deliver water to Mexico is currently in effect through November 9, 2013. Under terms and conditions of the contract, the District's pricing for energy and O&M costs attributable to water delivered to Mexico is due no later than 45 days prior to the start of each calendar year (CY) and will remain constant for the calendar year. To meet this required timing and adjust the rate effective January 1, 2011, the Board's approval of the new rate is due to the United States Commissioner no later than November 16, 2010.

Deliveries of water to Mexico are based on a purchase schedule provided by Mexico to the United States Commissioner on a calendar year basis. In order to set CY-2010 pricing, the Board requested District staff to perform a full review of prior pricing vs. actual costs incurred, since each year's deliveries are priced based on the most current prior year's costs. On March 3, 2010, staff presented the results of their review and the Board approved a rate for the remainder of the year of $65.41 per acre-foot. Although Mexico had initially requested water deliveries totaling 2,563.6 acre-feet for CY-2010, ultimately they requested all deliveries to be cancelled due to sufficient rainfall.

ANALYSIS:

Water is pumped to the Mexico connection from the District's 870-1 Pump Station, which also pumps water to the District's 870-1 Reservoir in the Otay Mesa area. There are a total of 4 energy bills (SDG&E) attributable to the pump station and these bills are used in the calculations for the energy portion of the rate the District charges Mexico. The water volumes pumped to both Mexico and the reservoir are added together, and the energy costs for Mexico are allocated based on the respective percentage of the total water volume. Similarly, maintenance costs for the District's distribution infrastructure from CWA to the Mexico border connection are computed based on Mexico's percentage of the total water volume pumped through that portion of the District's infrastructure. The energy costs are then added to the maintenance and repair costs and expressed as an overall rate per acre-foot.

Energy and operations and maintenance expenses have remained relatively stable since the last pricing update. Based on the methodology described above, staff has recalculated the "unit payment due OWD for delivery charges and other expenses ($/acre-foot)" to be used by the San Diego County Water Authority (CWA) on their monthly billing invoices to Mexico for water deliveries. Effective January 1, 2011, the proposed rate is $68.45 per acre-foot which is an increase of 4.6% from calendar year 2010 to 2011.

FISCAL IMPACT:

None. This adjustment maintains the District in a projected cost neutral position.

STRATEGIC OUTLOOK:

The District ensures its continued financial health through long-term financial planning, formalized financial policies, enhanced budget controls, fair pricing, debt planning, and improved financial reporting.

LEGAL IMPACT:

None.

General Manager

Attachments:

A) Committee Action Form
B) Rate Calculation Sheet

ATTACHMENT A

SUBJECT/PROJECT:	Rate Adjustment for Mexico Agreement to Transfer Water

COMMITTEE ACTION:

The Finance, Administration, and Communications Committee recommend that the Board authorize the General Manager to adjust the wheeling rate for the delivery of Treaty Water to the City of Tijuana to $68.45 per acre-foot for Calendar Year 2011.

NOTE:

The "Committee Action" is written in anticipation of the Committee moving the item forward for board approval. This report will be sent to the Board as a committee approved item, or modified to reflect any discussion or changes as directed from the committee prior to presentation to the full board.

Mexico Water: Energy / O&M Costs
870/571 Reservoirs / Pump Stations
Fiscal Years 2009 - 2010

ATTACHMENT B

Calculation of Costs, Based on Audited Fiscal Year Expenses

Costs	**O&M**	**Energy**	**Total**
FY 2009	187,478.36	423,531.09	611,009.45
FY 2010	89,083.57	210,268.14	299,351.71
Totals	$ 276,561.93	$ 633,799.23	$ 910,361.16

Consumption or Sales (In AF)	**PZ 871**	**Mexico**	**Total**
FY 2009	3,631.02	5,710.20	9,341.22
FY 2010	3,168.47	1,204.80	4,373.27
Totals	6,799.49	6,915.00	13,714.49

Unit Cost (per AF)	**O&M**	**Energy**	**Total**
FY 2009	20.07	45.34	65.41
FY 2010	20.37	48.08	68.45

Mexico Water Rates, on a Calendar Year Basis

CY Charges to Mexico	**O&M**	**Energy**	**Total**
CY 2010	20.07	45.34	65.41
CY 2011	20.37	48.08	68.45

AGENDA ITEM 6

OTAY WATER DISTRICT ESTABLISHED 1956

STAFF REPORT

TYPE MEETING:	Regular Board	MEETING DATE:	November 3, 2010	
SUBMITTED BY:	Geoff Stevens, Chief Information Officer	W.O./G.F. NO:		DIV. NO.
APPROVED BY: (Asst. GM):	German Alvarez, for G. Alvarez Assistant General Manager, Finance and Administration			
SUBJECT:	REPLACEMENT OF PBX			

GENERAL MANAGER'S RECOMMENDATION:

That the Board authorize the General Manager to negotiate and enter into an agreement with:

1. Advanced Call Processing Corporation in an amount not to exceed $400,000 for telecommunications equipment and services.

2. Fandel Enterprises for an amount not to exceed $40,000 for telecommunication consulting and implementation services.

COMMITTEE ACTION:

See Attachment "A".

PURPOSE:

To authorize the purchase of telecommunications equipment and implementation of services to replace the District's PBX and related systems.

ANALYSIS:

IT Staff has been analyzing the future requirements for District telecommunications needs. To assist in that effort, the District contracted a telecommunications consultant, Fandel Enterprises, to assess the condition of the District's telecommunications systems and to make recommendations to improve these services.

This effort consisted of:

- Condition and risk assessment of our current environment.
- Review of industry technology trends and best practices to assess current and future requirements.
- Development of a "requirements" document.
- Issuing a Request for Proposal (RFP) for communication system upgrades and receiving quotes for services.
- Alternative analysis, including the potential to outsource certain services and an assessment of the viability of moving to the latest voice over internet protocol (VoIP) technology.

As a result of these efforts, the following major conclusions have been reached:

- The District's PBX systems are near maximum capacity and at the end of their product life.
- The Voice Over IP technology is mature and is now an industry standard that is appropriate for Otay.
- Innovative phone software offers significant opportunities to enhance customer service and reduce costs for customer interaction.

The District last purchased an enterprise PBX system in January 2006 and chose to upgrade the NEC PBX originally purchased in 1993. While we were exploring with moving to VOIP technology at that time, the technology was not considered mature. Today VOIP is the standard, and the choice is clear. With the conversion to VOIP technology, the systems that meet the District's requirements are all complete replacements and consequently, upgrading is not an option.

Outsourcing

The outsourcing option was investigated. The District requested a bid from AT&T, (Cox does not provide an enterprise outsource solution) but the initial cost was more than purchasing a new system and the annual costs in the following year were much higher than annual license fees. In addition, outsourcing would mean an unacceptable loss of control over a critical District service with no financial benefit.

Value Added Services

What is significant (in our extensive two year analysis) is that current telecommunications technology is now digitally based; therefore the District can now move to voice over our data network and eliminate the need to replace the separate telecommunications wiring infrastructure. In addition, the processing of voice - be it in-bound, out-bound, interactive voice response (IVR), or automated call direction (ACD) - is now a software-based process as opposed to a hardware-based switching technology. This change means that the tools for managing these interactions can now be used to enhance the value or efficiency of this type of communications. The District can now use this infrastructure to reach and respond to customers in new and more efficient ways. It is expected that ratepayers will receive excellent communication and customer service.

Consequently, this upgrade - while completely necessary from a lifecycle perspective of the existing equipment (no longer vendor supported) - is also a good opportunity to upgrade our technologies' ability to assist in providing better and more dynamic customer service.

For example, staff interviewed several companies to understand how they are using these new products. One manager described how he now reacts to web traffic, establishes chat sessions, redirects calls, and sends an outbound reminder on a routine basis to his customers. Another stated that the advanced features have the capability to alert all customer service representatives when a particular call or wait time is exceeding specified limits. We anticipate the need to simplify and enhance our customer service business processes using this type of technology.

Purchasing Process

Staff issued a "Request For Information" (RFI), and based on the information received, an RFP was developed and issued in accordance with the District's purchasing process. The District received the following responses meeting the RFP requirements:

Respondent	Price
NEC Corp. of America (NEC)	$309,345
Logicalis	$336,035
Advanced Call Processing Inc. /I3 (ACP)	$385,000
American TeleSource Inc. (ATI)	$329,439

All four respondents were invited to an interview process which resulted in NEC, Logicalis, and ACP being invited to a final round of interviews. The interview panel members were Andrea Carey, Customer Service Supervisor; Alice Mendez-Schomer, Customer Service Supervisor; Bruce Trites, Network Engineer; Cynthia Alcantara, Business Analyst; and Bill Jenkins, Manager IT Operations. Geoff Stevens, CIO; and Steve Dobrawa, Purchasing and Facilities Manager observed and provided advice during the evaluation process.

The team determined that the ACP / Interactive Intelligence product was the best fit. While the cost ($385,000) was 20% higher than the second place candidate (NEC), the team was in agreement that the ACP product was superior in its ability to provide enhanced and flexible customer service and was a large step above the second place product in meeting the District's needs, particularly with regard to maintenance and software controlled flexibility.

These findings were validated by panel members Geoff Stevens and Andrea Carey who conducted detailed interviews with ACP clients. ACP is the leading provider of software-based telecommunications solutions and provides an unparalleled and flexible approach to call processing. It is simply a much better product than the other four we evaluated. The trend to software based control of telecommunications processes is expected to increase and moving to this approach supports the District's Strategic Plan to "Optimize use of Voice Over Internet Protocol and unified messaging."

Project Timeline

The PBX and related services will be replaced prior to June 2011.

Consulting Assistance Required

The cost of implementation services are $40,000. These services were competitively bid and Fandel Enterprises was the lowest bidder, by over 25% as presented in the following table.

Consultant	Price
Fandel Enterprises	$40,000.00
Wallis Victory & Associates	$70,000.00
Telytics, Inc.	$80,000.00

The District has established an ongoing consulting relationship with Fandel Enterprises and based on the positive past experience, staff is confident that Fandel Enterprises is more than capable of providing the needed services.

FISCAL IMPACT: RCB

This project will utilize funds from two CIPs. The hardware will use CIP P2501 and will be purchased in FY2011. The services will utilize CPI P2469 and will be purchased in FY2011. The total expenditures requested are for a not-to-exceed amount of $440,000 with funds budgeted from Capital Improvement Programs (CIP P2501 and CIP P2469). These items are also specifically included in the existing FY2011 Capital Budget and recommended FY2011 Capital Budgets.

The approved FY2011 budget is $400,000 for CIP P2501 (Telecommunications Equipment Upgrade). Expenditures to date are $0. The total FY2011 budget for CIP P2469 is $300,000 with current expenditures of $55,724 leaving a balance of $344,726. The Project Manager anticipates, based on financial analysis, that the budgets will be sufficient to support both projects.

Finance has determined that 100% of the funding for the hardware component of this project (P2501) is available from the "Replacement Fund" and the services component of this project (P2469), which is 60% of the funding, is available from the "Replacement Fund" and 40% from the "Expansion Fund."

STRATEGIC GOAL:

This project will achieve in total or part the following goals and objectives in the 2011 Strategic Plan.

3.2.3.2	Optimize use of Voice Over Internet Protocol and unified messaging.
1.1.2.1	Enhance communication with our customers by evaluating and upgrading all aspects of the District's phone system.

LEGAL IMPACT:

None.

General Manager

Attachment A - Replacement of PBX
Attachment B - PBX Replacement PowerPoint

ATTACHMENT A

SUBJECT/PROJECT:	REPLACEMENT OF PBX

COMMITTEE ACTION:

The Finance, Administration and Communications Committee met on October 19, 2010 to review this item. The Committee supports presentation to the full Board for their consideration.

Note:

The "Committee Action" is written in anticipation of the Committee moving the item forward for board approval. This report will be sent to the Board as a committee approved item, or modified to reflect any discussion or changes as directed from the committee prior to presentation to the full board.

PBX Replacement

Finance and Administration Committee

October 19, 2010

Geoff Stevens CIO

Otay Water District

ATTACHMENT B

Background – PBX

- PBX (Private Branch Exchange) – the "Switch"
- NEC PBX first installed in 1993
- Upgraded twice in 2000 and 2006
- Current PBX is at the end of due to the lack of vendor support

Technology

- PBX replacement identified in FY2011 Strategic Plan
- The new industry standard is VoIP
- Transition from hardware "Switch" to software solution for management of calls

Selection Process

- Industry and Technology Review
- RFI issued to gather perspective
- RFP for specific requirements
- Panel interviewed all bidders
- Shortlisted to 3 Finalists
- Top respondent selected and references checked
- Develop recommendations for Board

Implementation Services

- Complex project requires Implementation Services
  - Highly detailed requirements
  - Shift in technology
  - Critical District system
- Solicited bids / received 3 responses
- Selected lowest bidder
  - Excellent history with the District
  - Performed similar projects / broad knowledge-based

Summary

- Selected "Interactive Intelligence"
- Proven software-based solution
- Leverages VoIP Technology
- Significantly better functionality and ease of use /faster ROI
- Positions Otay for any future changes
- Customer Service runs the system and process
- IT provides support
- $400,000 hardware software / $40,000 Implementation

Schedule

- Installed by June 2011
- Extensive training
- But – it is new, different, and may take some time getting comfortable with it
- "It was everything we hoped for and more" (reference check interview)

Interactive Intelligence Winner 2010 North American Technology Company of the Year

- "There are fundamental differences between communications-enabled business process solutions and IPA," Outlaw said. "Instead of merely embedding communications functions into applications, Interactive Intelligence has opted to use its core communications platform as the basis for automation. In this way, IPA gives customers the ability to automate and track entire multi-step processes – including those that fall outside of communications -- thus providing significant and measurable ROI."

AGENDA ITEM 7

STAFF REPORT

TYPE MEETING:	Regular Board	MEETING DATE:	November 3, 2010
SUBMITTED BY:	Stephen Dobrawa, Purchasing Manager	W.O./G.F. NO:	DIV. NO. All
APPROVED BY: (Chief)	Rom Sarno, Chief, Administrative Services Joseph Beachem, Chief Financial Officer		
APPROVED BY: (Asst. GM):	German Alvarez, Assistant General Manager, Finance and Administration		
SUBJECT:	AMENDMENT OF THE DISTRICT'S PURCHASING MANUAL SECTION 7.2.8, BOARD AUTHORIZED PURCHASES EXCEEDING THE GENERAL MANAGER'S AUTHORITY		

GENERAL MANAGER'S RECOMMENDATION:

That the Board amend the District's Purchasing Manual Section 7.2.8, Board Authorized Purchases Exceeding the General Manager's Authority, as identified in "Attachment B".

COMMITTEE ACTION:

See "Attachment A".

PURPOSE:

To request that the Board amend the District's Purchasing Manual as presented in "Attachment B".

ANALYSIS:

The Board of Directors establishes the operational guidelines and procedures with respect to purchasing the materials, equipment, and services necessary to conduct the District's business. These procedures are defined and published in the District's Purchasing Manual.

As a normal course of business, the manual is reviewed from time-to-time and changes to it are recommended that are intended to improve the operation of the District.

Employee Benefits

The District provides benefits to its employees. These benefits are generally defined and established through the negotiated collective bargaining agreement or by direction of the Board. In some instances, employee benefits are mandated through State and Federal statute. In providing these benefits, the District realizes direct and indirect costs that routinely exceed the General Manager's signatory authority. In the past, it has been the District's practice to present changes to benefit providers to the Board for approval and to allow the General Manager to utilize the approved providers as necessary without regard to the General Manager's signatory authority.

It is recommended that the Board amend the Purchasing Manual to provide authority to the General Manager to select and enter into agreements with benefit providers and brokers as required to meet the District's obligations related to employee benefits.

This action will make it clear that the General Manager has authority to exceed his/her signatory authorization limit with regard to providing employee benefits as established by the Board.

Banking Services

Banking Services consists of numerous financial and operational functions that are critical to the continuing daily operations of the District. Included in this are the following: 1) multiple deposit accounts for operations, payroll, investments, debt service, etc.; 2) check payment processing; 3) wire and ACH services for automated payments and receipts; 4) lockbox processing for receipt of customer payments; 5) links to third-party vendors for receipt of customer credit card payments; and 6) other routine services required for District daily operations.

Over 48,000 District customer payments interface with the banking services on a monthly basis. Also, over $100 million of District funds from all sources are handled through banking services on an annual basis. Based on this volume of services, and the criticality of the services to the District's smooth running daily operations, it is important that the adverse impact resulting from changes to banking services be considered, and that changes to banking services providers be kept to a minimum. In the past, it has been the District's practice to present changes to banking services providers to the Board for approval and to allow the General Manager to utilize the approved providers as necessary without regard to the General Manager's signature authority.

It is recommended that the Board amend the Purchasing Manual to provide authority to the General Manager to select and enter into agreements with banking services providers as required to meet the District's banking obligations on a continuous basis.

This action will make it clear that the General Manager has authority to exceed his/her signatory authorization limit with regard to providing banking services as required to operate the District.

FISCAL IMPACT: RKB

None.

STRATEGIC GOAL:

Ensure financial health through formalized policies, prudent investing, and efficient operations.

LEGAL IMPACT:

None.

General Manager

Attachment A - Committee Action
Attachment B - Amended Purchasing Manual, Section 7

ATTACHMENT A

SUBJECT/PROJECT:	AMENDMENT OF THE DISTRICT'S PURCHASING MANUAL SECTION 7.2.8, BOARD AUTHORIZED PURCHASES EXCEEDING THE GENERAL MANAGER'S AUTHORITY.

COMMITTEE ACTION:

The Finance, Administration and Communications Committee reviewed this item at a meeting held on October 19, 2010. The Committee supports presentation to the full Board for their consideration.

NOTE:

The "Committee Action" is written in anticipation of the Committee moving the item forward for board approval. This report will be sent to the Board as a Committee approved item, or modified to reflect any discussion or changes as directed from the Committee prior to presentation to the full board.

ATTACHMENT B
Amended Purchasing Manual, Section 7

7.0 PURPOSE

To provide requirements, policies, and guidelines for the pricing/bidding of purchases within the Otay Water District.

7.1 GENERAL

It is the District's policy to request competitive quotations from responsible vendors for all purchase items priced at more than $5,000. Pricing, although important, is not the only factor in determining the overall cost and value of a product. Quality, service, and delivery are factors that must also be considered when comparing quotations. It is by weighing these factors that an intelligent decision can be made to purchase the product with the greatest value for the least overall price.

7.2 REQUIREMENTS

7.2.1 Formal Advertising

Public work purchases, as defined in the State of California's Government and Contract Codes, equal to or exceeding $35,000 must be formally advertised. Solicitations shall be advertised in a newspaper of general circulation at least one, a minimum of ten (10) calendar days prior to the date of the bid opening. Solicitations must contain a brief description of the goods or services required, state where prospective bidders may obtain plans and specifications and make any required deposits, state the time and place of the bid opening, and state that the District reserves the right to reject one or all bids.

7.2.2 Quotations

For purchases greater than $5,000, excluding public work purchases exceeding $35,000 that require formal advertising and bidding, a minimum of three competitive quotations must be obtained. Quotations received may be in written or oral form. Should oral quotations be received, written documentation must be made identifying the bidder's name, contact name, telephone number, the date of the quotation and the price bid. Should three quotations not be obtainable, documentation in the form of a notation of memorandum must be provided and attached to the purchase requisition. Where only one price is obtainable, the actions taken to obtain competitive pricing shall be documented and attached to the purchase requisition and the purchase may be made and the requirements of this section shall be satisfied.

7.2.3 Public Work - Construction

Public work purchases equal to or exceeding $35,000 in value must be formally advertised and sealed bids received.

The Purchasing and Facilities Manager or the General Manager's designee, in conjunction with the project manager, and where appropriate, the District's legal counsel, shall publicly open all sealed bids and tabulate the results. The bid tabulation, along with a recommendation for award of contract or possible rejection of bids, shall be forwarded to the District's General Manager.

In the event that the value of the purchase exceeds the General Manager's signatory authority, a summary of bids shall be presented together with staff's recommendation for an award of contract or possible rejection of bids to the Board of Directors of the District during a formal board meeting. The Board of Directors will then authorize the execution of the contract on behalf of the District. Award shall be made to the responsive and responsible bidder who has submitted the lowest bid. After approval as to form and legality of the contract documents by legal counsel, the successful bidder and the appropriate District representative(s) shall execute the contract. A copy of the executed contract shall be promptly provided to the Finance Department for proper accounting review.

7.2.4 Request for Proposals

a. For the Solicitation of Professional Consulting:
The General Manager, or his/her designee, will establish a review panel to evaluate and rank submittals (proposals) using criteria published in the Request for Proposals package. Documents, invitations, and evaluation of submittals for professional consulting services shall be made in compliance with Government Code Section 4526-4529 and District Policy #21 - Policy for Selection of Professional Consultants.

b. For the Solicitation of General Consulting and Services:
The General Manager, or his/her designee, shall determine the method for soliciting and evaluating proposals for general consulting and services. The request for proposal must be in written form and must provide sufficient information to clearly identify the work required and provide respondents with a clear understanding of the District's needs, work specifications, expectations, and the criteria that will be used to evaluate submittals.

7.2.5 Two Step Bidding

Where it is considered impractical to initially prepare a purchase description to support an award on price, a request for proposals may be issued requesting the submission of not priced technical proposals. This will be followed by an invitation for bids limited to those bidders whose technical proposals meet the requirements set forth in the first invitation.

7.2.6 Purchases Exempt from Competitive Pricing

a. The following contract/purchases are exempt from competitive pricing (Ref: California Contracting Code 10335-10381):

Contracts:

1. With Federal, State or Local Agencies,
2. For temporary labor contracts for time-limited employment needs,
3. For services that can only be performed by a public agency,
4. For the sole purpose of obtaining expert witness for litigation, and
5. That are for legal defense, legal advice, or legal services.

7.2.7 Emergency Purchases

During times when the General Manager has declared an emergency, where the immediate acquisition of materials, goods, and services is required, the purchase of needed materials, goods, and services shall be made in accordance with California state statutes and per the District's Code of Ordinances.

7.2.8 Board Authorized Purchases Exceeding the General Manager's Authority

a. The General Manager or his/her Designee is authorized to exceed his/her delegated purchasing authority and purchase the following goods and services without regard to limits on the amount of delegated authority under Section 2 of the Code of Ordinance:

1. Gas and electric utility for the operation of the District.
2. Water.
3. Temporary labor services.
4. Chemicals and gasses for the treatment of potable and recycled water
5. Fuel, gasoline and diesel.
6. Employee medical, dental, vision, and/or fringe benefits as defined in any District collective bargaining agreement, authorized by the Board, or mandated by State or Federal statute, including through a broker.
7. Banking services.