Santa Margarita Water District

MEMORANDUM

TO: Finance and Administration Committee **DATE:** January 26, 2017

FROM: Daniel Ferons

SUBJECT: Fiscal Year 2017 Budget Reforecast Update.

SUMMARY

Issue: The District adopted the Fiscal Year 2017 Budget in conjunction with the District's Strategic Business Plan. The District has reviewed the actual results for the five-month period ending November 2016 and adjusted its projections for the remainder of Fiscal 2017 based on changes from both internal and external factors.

Recommendation: Information Item Only

Fiscal Impact: The reforecast of the FY 2017 budget projects the cash needs, purchases and expenses, and is used to determine the adequacy of rates and charges for the current fiscal year.

Previous Related Action: The Board approved the Fiscal Year 2017 budget on May 20, 2016 and annually reviews/adopts the District's budget.

Adherence to Policy: The budget reforecast adheres to the District's Investment Policy, Purchasing Policy, and Reserves Policy.

Anticipated Board Action: It is anticipated that this item will be presented to the Board on February 1st and 4th, 2017 to assist with the discussion on the District's financial structure.

DISCUSSION

The Fiscal Year (FY) 2017 Reforecast is a combination of actual results from June 2016 through November 2016 and a projection for the remainder of FY 2017. The projections include adjustments to the original FY 2017 budget that result from:

- Changes in customers' usage habits
- Updated expense run rates
- Timing differences between projections and actual results
- Improved accuracy in budget calculations
- Changes in Capital Expenditure (CAPEX) projections

SUMMARY ANALYSIS OF RESULTS

The FY 2017 Reforecast projects an improvement in Net Operating Income of $3.5 million over the original FY 2017 Budget. This improvement is largely the result of an increase in customer water usage over the original budget which assumed that the 24% water restrictions imposed by the state would continue throughout the fiscal year. The actual water use reduction through November was approximately 19%. The key adjustments to the projections include:

- Increases in water usage contributing an additional $5.8 million of revenue
- Increases in related water costs of $3.4 million
- Revised power costs which are lower than originally projected by $318 thousand
- Delays in hiring which decrease gross payroll expense by $756 thousand

Despite the improvements in Net Operating Income, the District's cash position continues to decline as Cash Flow available for CAPEX Activity of $6.9 million is substantially less than the $30.9 million required to fund net CAPEX activities. The key adjustments to CAPEX include:

- Net increases in Capital Funding of $11.2 million
- Additional Capital Project expenditures totaling $25.3 million

**FY 2017 REFORECAST
SUMMARY - (000'S OMITTED)**

	REFORECAST FY 2017	BUDGET FY 2017	VARIANCE $	VARIANCE %
TOTAL OPERATING REVENUE	$70,247	$64,422	$5,826	9.0%
NET OPERATING COSTS	(69,114)	(66,739)	(2,375)	3.6%
NET OPERATING INCOME	**1,133**	**(2,317)**	**3,451**	**-148.9%**
NET NON-OPERATING INCOME - ADJUSTED	8,682	8,536	145	1.7%
INCOME BEFORE FINANCING / CAPEX ACTIVITY	**9,815**	**6,219**	**3,596**	**57.8%**
FINANCING ACTIVITY				
SOURCES OF CASH	27,298	27,043	255	0.9%
USES OF CASH	(30,202)	(30,507)	305	-1.0%
NET FINANCING ACTIVITY	(2,904)	(3,464)	560	-16.2%
CASHFLOW AVAILABLE FOR CAPEX ACTIVITY	**6,911**	**2,755**	**4,156**	**150.9%**
CAPEX ACTIVITY				
SOURCES OF CASH	19,205	7,969	11,236	141.0%
USES OF CASH	(50,094)	(24,794)	(25,300)	102.0%
NET CAPEX ACTIVITY	(30,889)	(16,826)	(14,063)	83.6%
NET CASHFLOW	**($23,977)**	**($14,070)**	**($9,907)**	**70.4%**

The Reforecasted Net Cash Flow deficit of ($24.0) million will substantially reduce the District's cash position without either additional revenue from sources such as new bond issuances or a significant reduction or delay in the number of CAPEX projects. In order to adequately support the District's CAPEX program in the long term, the Board may consider reconfiguration of the financial structure of the District to both generate sufficient cash to support its operating activity, replenish reserves which have been substantially depleted, fund its repairs and replacement program, as well as funding new capital projects that improve the District's infrastructure.

1) ANALYSIS OF RESULTS – Operating Activity

- **Revenue**

The largest change in the Reforecast projections results from the increased usage of water. The original budget projected a continuation of the 24% water reduction mandate from the state throughout FY 2017. Through November 2016, the actual reduction in usage was approximately 19%. Potable Water revenue is projected to increase 17.9% from the original budget, largely the result of the change in demands that resulted from updated requirements from the State, changes in weather conditions, and growth. As a result, Potable Water revenue is projected to be $38.9 million, an increase $3.7 million over the original budget, with the water demand in the remainder of the year projected to be similar to the increase in usage experienced over the first five months of the year. (Table 1)

Recycled Water revenue is also projected to increase significantly, largely due to an increase in usage similar to that of Potable Water and the sale of recycled water for construction grading. This increase in usage results in projected Recycled Water revenue of $10.2 million, an increase of $1.2 million over the original budget or a 13.9% increase.

Wastewater revenue is projected to be $19.0 million, a net increase of $0.5 million. The increase is largely the result of adjustments in the calculations of both the fixed and variable portions of wastewater revenue. The adjustments included the higher fixed unit rates that were implemented in January 2017 and a reduction in volumetric charges. The reduced volume charges were largely due to a portion of customers reaching the maximum chargeable volume usage.

Other Income increased $0.3 million, largely the result of South County Pipeline reimbursements which were not included in the original budget.

Primarily as a result of the increased water usage, Total Operating Revenue is projected to increase $5.8 million over the original budget to $70.2 million. Although the increase over budget is significant, customers are continuing to conserve water and the usage of Potable Water is still approximately 19% below 2013 base levels.

- **Cost of Water**

The Cost of Water continues to be the largest cost component of the FY 2017 Reforecast. The volumetric portion of the expense increased $3.4 million. The increase over the original budget is largely the result of the increase in Potable Water usage as previously described. An additional component of the increase is the higher average cost of Potable Water per acre/feet due to the delay in the opening of the Baker Water Treatment plant. The basic fixed charges related to water costs are projected to be approximately the same as the original budgeted amounts.

Power costs are projected to be $5.8 million, a decrease of $0.3 million from the original budget. The decrease is largely due to the realization of lower power rates as negotiated by the District's utility consultant in prior years.

TABLE 1

FY 2017 REFORECAST CONSOLIDATED INCOME STMT (000'S OMITTED)	REFORECAST FY 2017	% OF REVENUE	FY 2017 REFORECAST VS. BUDGET FY 2017	% OF REVENUE	VARIANCE $	VARIANCE %
REVENUE						
TOTAL POTABLE WATER	$38,884	55.4%	$35,143	54.6%	$3,741	10.6%
TOTAL RECYCLED WATER	10,229	14.6%	8,984	13.9%	1,245	13.9%
TOTAL WASTE WATER	19,036	27.1%	18,526	28.8%	509	2.7%
UTILITY BILLING CHARGES	787	1.1%	750	1.2%	37	4.9%
TOTAL WATER REVENUE	**68,935**	**98.1%**	**63,404**	**98.4%**	**5,531**	**8.7%**
TOTAL OTHER INCOME	1,384	2.0%	1,090	1.7%	294	26.9%
LESS: BAD DEBT RESERVE	(72)	-0.1%	(72)	-0.1%	1	-0.7%
TOTAL OPERATING REVENUE	**70,247**	**100.0%**	**64,422**	**100.0%**	**5,826**	**9.0%**
COST OF WATER						
TOTAL WATER PURCHASES	24,812	35.3%	21,437	33.3%	3,375	15.7%
TOTAL FIXED CHARGES	7,031	10.0%	7,067	11.0%	(36)	-0.5%
POWER CHARGES - NET	5,789	8.2%	6,107	9.5%	(318)	-5.2%
TOTAL COST OF WATER	**37,632**	**53.6%**	**34,611**	**53.7%**	**3,022**	**8.7%**
NET OPERATING MARGIN	**$32,615**	**46.4%**	**$29,811**	**46.3%**	**$2,804**	**9.4%**

- **Net Operating Margin**

The FY 2017 Reforecasted Net Operating Margin is the Total Operating Revenue less the Total Cost of Water. This represents income related to the basic delivery of water to customers. This also represents income that is available to cover basic operating costs. The Net Operating Margin is projected to be $32.6 million, an increase of $2.8 million over the original budget. This increase is a 9.4% increase in Net Operating Margin over the original budget.

- **Net Payroll Expense**

Net Payroll Expense of $18.85 million continues to be the second largest cost component of the FY 2017 Reforecast. Gross Payroll includes base salaries, other wages and payroll benefits. Gross Payroll is projected to be $19.96 million, a decrease of $756 thousand from the original budget. The decrease is a result of delays in the anticipated hiring of new and replacement personnel. This decrease along with the increase in water usage revenue causes Gross Payroll as a percentage of Operating Revenue to fall from 30.7% in the original budget to 26.8% in the Reforecast. (Table 2)

The Capitalized Payroll Adjustment of $1.10 million in the Reforecast versus $967 thousand in the original budget represents the shift of certain payroll activity related to the District's long-term CAPEX program. This is an accounting adjustment that reduces the level of expense in the Operating Statement, but increases the total CAPEX cost by the same amount. Although the Net Payroll expense is reduced to $18.85 million, the true cash cost of payroll is $19.96 million.

TABLE 2

FY 2017 REFORECAST CONSOLIDATED INCOME STMT (000'S OMITTED)	REFORECAST FY 2017	% OF REVENUE	FY 2017 REFORECAST VS. BUDGET FY 2017	% OF REVENUE	VARIANCE $	VARIANCE %
GENERAL OPERATING EXPENSES						
GROSS PAYROLL	$19,960	28.4%	$20,716	32.2%	($756)	-3.6%
LESS: CAPITALIZED PAYROLL ADJ	(1,108)	-1.6%	(970)	-1.5%	(138)	14.2%
NET PAYROLL EXPENSE	**18,852**	**26.8%**	**19,746**	**30.7%**	**(894)**	**-4.5%**
WATER USE PROGRAMS	445	0.6%	519	0.8%	(74)	-14.2%
REPAIRS AND MAINTENANCE	5,238	7.5%	4,770	7.4%	468	9.8%
SUPPLIES	3,048	4.3%	2,941	4.6%	107	3.6%
OTHER OPERATING ACTIVITY	1,169	1.7%	1,296	2.0%	(127)	-9.8%
OTHER G&A	5,354	7.6%	5,585	8.7%	(231)	-4.1%
TOTAL GENERAL OPERATING EXPENSES	**34,107**	**48.6%**	**34,857**	**54.1%**	**(750)**	**-2.2%**
LESS: JOF EXPENSE REIMBURSEMENT	(2,625)	-3.7%	(2,729)	-4.2%	104	-3.8%
NET GENERAL OPERATING EXPENSES	**31,482**	**44.8%**	**32,128**	**49.9%**	**(647)**	**-2.0%**
NET OPERATING INCOME	**1,133**	**1.6%**	**(2,317)**	**-3.6%**	**3,451**	**-148.9%**
NET NON-OPERATING INCOME / (EXPENSE) - ADJ	8,682	12.4%	8,536	13.3%	145	1.7%
INCOME BEFORE FINANCING/CAPEX ACTIVITY	**$9,815**	**14.0%**	**$6,219**	**9.7%**	**$3,596**	**57.8%**

Water Use Programs

Water Use Programs include special rebates and programs related to activities that encourage customers to conserve and reduce wasteful water use. Although expenses to date have been much lower than originally budgeted, it is expected that most of the costs will be incurred in the second half of the year.

- **Repairs and Maintenance**

The District experienced several unexpected repair events which exceeded overall projections in the first five months of the year. Repairs that were delayed from the first part of the year have been shifted to the second part of the year to ensure that all needed repair work is completed. This resulted in an increased Reforecast of $468 thousand over the original budget.

- **Supplies**

The increase in projected Supply costs from $2.94 million in the original budget to $3.05 million in the Reforecast is primarily an expected increase in the use of chemicals related to odor control treatment at the Wastewater plants. Depending on the strength of wastewater flowing through the plants, the increased use of chemicals is often required to adequately control the treatment process.

- **Other Operating Activity**

The majority of the decrease in Other Operating Activity is the decrease in expected costs for Solids and Screenings Disposal from the original budget. Significantly higher disposal rates were anticipated for FY 2017, but the run rates for the first five months of the year suggest that the rates have been similar to FY 2016 expense rates. As a result, the projections were decreased along with Laboratory Analysis and Safety costs which have also been reduced from their higher budgeted levels. The total decrease for all accounts was $127 thousand from the original budgeted amounts.

- **Other General and Administrative (G&A)**

Other General and Administrative includes all other office G&A activity that supports the primary operating activities of the District. For the FY 2017 Budget, a number of expense accounts were expected to increase significantly, but actuals through November have shown a lower level of expenditures. Included in these costs are expected overall savings in accounts such as Professional, Bond-Related Fees and Public Relations, although some of the reduced costs for the first five months of the year have been deferred to the second half of FY 2017. The result is an expected reduction in all Other G&A expenses of $231 thousand from the original budget.

- **JOF Expense Reimbursement**

The District has a number of Joint Operating Facilities (JOF) which it shares with other water districts. These facilities are run and maintained by the District and expenses are shared among the participating districts. The District regularly bills the participating districts for their share of the expenses of operating the JOF in order to recover part of the gross operating costs. For the FY 2017 Reforecast, the allocation of expenses to other participating districts was reduced by $104 thousand due to the overall reduction in expenses in the Reforecast.

- **Net Operating Income**

Net Operating Income represents the income the District generates from its basic operating activity, after recovering the cost of expenses that are shared with other water districts. The FY 2017 Reforecast projects a Net Operating Income of $1.1 million versus a net loss of ($2.3) million in the FY 2017 Budget or an improvement of $3.5 million. The improvement is primarily the result of the increase in customer water usage and revenue, offset by the higher Cost of Water that results from the incremental increase in water usage. Overall expense savings totaling $647 thousand also contributed to the increase in Net Operating Income. Although the Net Operating Income is projected to be slightly positive in the Reforecast, this the result of the accounting shift of $1.1 million of capitalized payroll to CAPEX. Subtracting the actual cash cost of the accounting shift shows a net breakeven in operating activity.

2) <u>NET NON-OPERATING INCOME / (EXPENSE) - ADJUSTED</u>

Non-Operating Income / (Expense) - Adjusted includes activity that is not directly related to the normal operating activities of the District, but are ancillary activities that provide revenue that can supplement both the operating activities as well as the long-term needs of the district. Some revenue is normal and recurring, while other revenue can be short-term in nature. Certain income accounts such as Investment Mark to Market and Gains from Reimbursement Agreement Expirations are non-cash activities and as a result, are excluded from this analysis of District cash flows. The total improvements in Non-Operating activity results in an increase in income of approximately $145 thousand over the original budget.

- **Key Non-Operating Income / Expense Accounts**

Property Tax Receipts – General are the District's share of 1% general property taxes collected by the County of Orange and distributed to the District every year as property owners pay their assessed taxes. The amount distributed to the District is dependent on the assessed land value of property within the district and will increase or decrease, depending on changes in property values. The FY 2017 Reforecast was increased by $229 thousand from the original budget due to the significant increase in tax receipts experienced in FY 2016.

Solar Power – Credits Earned are the result of excess solar power produced by the Districts two solar panel arrays located the District headquarters and the Chiquita Wastewater Reclamation Plant. The Reforecast of credits earned was lowered to $381 thousand from $452 thousand as a result of a number of defective power inverters reducing the overall solar production significantly during the peak summer periods.

Cadiz – Reimbursable Expense / Expense Reimbursements are related to activity to determine the viability of the Cadiz Groundwater Project as a potential source of water. Expenses related to the project are reimbursed by Cadiz so that there is no net cost to the District during this phase of the project. Expenses during the first five months of the year have been significantly less than budgeted, which results in the related reimbursements being equally reduced.

- **Income Before Financing / CAPEX Activity**

Income Before Financing / CAPEX Activity represents all operating and non-operating activity of the District before taking into account cash flows related to Financing Activity and CAPEX Activity. This is essentially all of the short term cash made available for longer term cash needs such as capital expenditures and the funding of reserves. The Reforecast projects an increase in Income Before Financing / CAPEX Activity of $3.6 million, again largely a result of the increased customer water usage along with general expense reductions.

3) FINANCING ACTIVITY

- **Sources of Cash**

Sources of cash from Financing Activities consist primarily of Property Tax Receipts – Debt Service which are dedicated to the servicing of principal and interest payments for specific bond issues. Excess collections of property taxes above the calculated tax rate are set aside in Debt Service Stabilization Reserves to reduce the tax burden on rate payers in future years to the extent that these tax reserves are available. For the current year, an estimated $3.5 million of cash reserves were utilized to reduce the tax burden on rate payers in FY 2017. Projections of receipts for the Reforecast did not change appreciably from the original budget. (Table 3)

Additional sources of cash from Financing Activities include interest income from the investment of available cash. The interest income for the FY 2017 reforecast is approximately $287 thousand higher than the original budget which forecasted a more conservative level of available cash for investment.

- **Uses of Cash**

Uses of cash from Financing Activities include principal and interest payments for bonds as well as state revolving fund loans. The original budget also included the use of capital leases to fund a portion of CAPEX related to the installation of the TERP system. The Reforecast assumes that the TERP system would be funded from available cash rather than a capital lease because the spread of the installation over several years results in an inefficient lease structure that limits its benefits to the District. As a result, total debt service is reduced by $305 thousand over the fiscal year.

- **Net Cash Flow Available for CAPEX Activity**

Net Cash Flow Available for CAPEX Activity represents net short term cash available to fund the District's CAPEX activity. Income Before Financing / CAPEX Activity combined with the Net Financing Activity is projected to generate $6.91 million of cash to fund CAPEX activity. The increase in cash flow of $4.16 million over the original budget is primarily the result of higher revenues from the increased usage of water along with general expense reductions.

TABLE 3

FY 2017 REFORECAST CONSOLIDATED INCOME STMT (000'S OMITTED)	REFORECAST FY 2017	% OF REVENUE	FY 2017 REFORECAST VS. BUDGET FY 2017	% OF REVENUE	VARIANCE $	VARIANCE %
FINANCING ACTIVITY						
SOURCES OF CASH						
PROPERTY TAX RECEIPTS - DEBT SERVICE	$26,255	37.4%	$26,287	40.8%	($32)	-0.1%
INTEREST INCOME - NET CASH	1,044	1.5%	757	1.2%	287	37.9%
TOTAL DEBT SERVICE REVENUE SOURCES	**27,298**	**38.9%**	**27,043**	**42.0%**	**255**	**0.9%**
USES OF CASH						
DEBT SERVICE PAYMENTS - BONDS	29,160	41.5%	29,175	45.3%	(15)	-0.1%
DEBT SERVICE PAYMENTS - SRF LOANS/OTHER	1,042	1.5%	1,332	2.1%	(290)	-21.8%
TOTAL DEBT SERVICE USES	**30,202**	**43.0%**	**30,507**	**47.4%**	**(305)**	**-1.0%**
NET FINANCING ACTIVITY	**(2,904)**	**-4.1%**	**(3,464)**	**-5.4%**	**560**	**-16.2%**
NET CASHFLOW AVAILABLE FOR CAPEX ACTIVITY	**$6,911**	**9.8%**	**$2,755**	**4.3%**	**$4,156**	**150.9%**

4) CAPEX ACTIVITY

- **Sources of Capital Funding**

Sources of Capital Funding include proceeds from the issuance of new debt, grant proceeds, as well as capital reimbursements for CAPEX activity that the District performs in conjunction with other public agencies and land developers. Although projected in the original budget, the availability of new bond funds of $7.13 million is not assumed in the Reforecast. This decrease in new funding is offset by the expected receipt of grant funding of $1.64 million which was not budgeted, $3.0 million of loan funds related to the Lake Mission Viejo project, as well as $13.73 million of additional capital reimbursements which were not budgeted due to the low level of CAPEX in the original budget. The result is a net increase in the sources of capital funding of $11.23 million. (Table 4)

- **Uses of Cash**

The District's CAPEX consists of its Construction In Progress (CIP) as well as other CAPEX that is immediately depreciable upon acquisition. The increase in CIP of $27.84 million includes $2.54 of TERP CAPEX that was transferred to CIP due to the long term nature of the TERP implementation program. The higher CIP includes a significant number of repairs and replacement activities which were not included in the original budget. The increased CIP also includes several long term projects that are expected to begin in FY 2017, but were not included in the original budget.

As a result of the increased number of CAPEX projects, the Net CAPEX Activity in the Reforecast is projected be $30.89 million, an increase of $14.06 million over the original budget.

TABLE 4

FY 2017 REFORECAST CONSOLIDATED INCOME STMT (000'S OMITTED)	REFORECAST FY 2017	% OF REVENUE	BUDGET FY 2017	% OF REVENUE	FY 2017 REFORECAST VS. VARIANCE $	%
CAPEX ACTIVITY						
SOURCES OF CAPITAL FUNDING						
NEW BOND/LOAN PROCEEDS/LEASES	$3,000	4.3%	$7,131	11.1%	($4,131)	-57.9%
GRANT PROCEEDS	1,637	2.3%	0	0.0%	1,637	0.0%
CAPITAL REIMBURSEMENTS	14,568	20.7%	837	1.3%	13,731	1639.8%
TOTAL SOURCES OF CAPITAL FUNDING	19,205	27.3%	7,969	12.4%	11,236	141.0%
USES OF CASH						
CIP - CAPITAL REPAIRS/REPLACEMENT	12,262	17.5%	20,084	31.2%	(7,822)	-38.9%
CIP - NEW DEVELOPMENT	18,773	26.7%			18,773	0.0%
CIP - RELIABILITY/REGIONAL PROJECTS	16,890	24.0%			16,890	0.0%
OTHER CAPEX	2,169	3.1%	4,710	7.3%	(2,541)	-53.9%
TOTAL FIXED ASSET ADDITIONS	50,094	71.3%	24,794	38.5%	25,300	102.0%
NET CAPEX ACTIVITY	(30,889)	-44.0%	(16,826)	-26.1%	(14,063)	83.6%
NET CONSOLIDATED CASHFLOW	($23,977)	-34.1%	($14,070)	-21.8%	($9,907)	70.4%

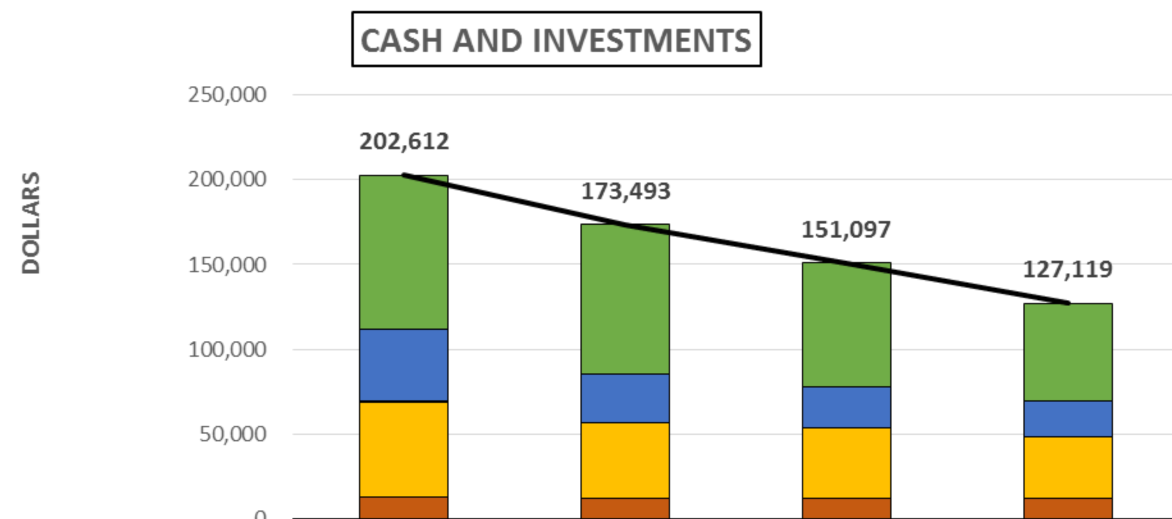
- **Net Consolidated Cash Flow**

The FY 2017 Reforecast projects a net cash shortfall of ($23.98) million, an increased shortfall of ($9.91) million from the original budget cash flow shortfall of ($14.07) million. This illustrates the District's use of construction funds and reserves on hand and highlights that short term cash activity is not sustaining the District's long term CAPEX obligations.

The original budget included the use of reserves to fund the original shortfall. However, the use of reserves is a use of cash and is not a consistent source of funding. Reserves are cash generated from prior year activity such as the issuance of bonds to fund larger CAPEX projects where cash is received immediately and is disbursed over time as the projects are constructed, often over several years. Reserves are also generated from excess funds from operations, although we have seen that large fluctuations in customer water usage can have significant effects on the District's ability to fund reserves through operating activity.

Although the District has a certain level of bond funds available for CAPEX activity, each individual bond fund has restrictions as to how the funds are utilized which may make them unavailable for use on specific current projects. This forces the District to deplete existing cash reserves which have not been replenished for several years. (Table 5)

TABLE 5



	6/30/2014	6/30/2015	6/30/2016	6/30/2017
CASH/INVESTMENTS	90,450	88,103	73,498	57,500
DEBT SERVICE RESERVES	42,502	28,500	23,990	21,087
CASH - THIRD-PARTY	602	261	124	124
BOND PROCEEDS - LT	56,564	44,528	41,450	36,374
BOND RSRV FUNDS - LT	12,494	12,101	12,035	12,035
TOTAL CASH/INVESTMENTS	202,612	173,493	151,097	127,119

The District's cash balances is a component of its credit rating, and lower projected balances may impact the cost of borrowing. Coupled with the anticipated increase in interest rates over the coming years, the result may be higher debt service costs for new bond issues.

TOPICS FOR FURTHER DISCUSSION

As previously discussed, in order to fund the District's current CAPEX program, significant changes in the District's funding policies may be appropriate. The District's two primary sources of cash generation, rates and debt service, are under review to determine options to adequately fund critical CAPEX projects as well as minimizing the financial impact on its customers.

The District's current rate structure, based on the rate study performed in 2015, did not adequately provide sufficient funding when large structural changes in the business occurred. Events such as the recent drought reduction mandates from the state and subsequent relaxing of the rules caused large fluctuations in customer water usage and added to the uncertainty of cash generation from rates.

The District is currently analyzing the current rate structure in order to determine the level of funding necessary to properly fund operating activities. In addition, the rate structure must also support certain debt service that is repaid from operating funds, replenish cash reserves that have been depleted over the past several years, as well as fund certain CAPEX that adequately maintains the District's infrastructure.

The District is also currently analyzing various debt instruments that can fund longer term CAPEX projects. The use of rates has certain restrictions which limit their ability to fund certain CAPEX projects, so the District must explore other funding sources to support these large projects. Because several of the projects provide benefits to all customers and are long term solutions to the District's structural goals, long term debt instruments are a more stable and predictable source of funding for these types of long term assets.

Consideration of the use of reserves and the related cash balances is also a critical part of the District's financial structure. Although the District has a significant cash balance, the constant use of reserves has substantially depleted the District's cash levels over time. Cash balances are one of several factors that affect the District's credit rating which in turn will affect the District's borrowing costs if debt instruments are issued.