

As many of you know, this Board inherited significant financial issues when we took office in December 2010. Through prudent fiscal management over a 20 year period, the District had accumulated nearly \$6.5 million in cash reserves . Between 2008 and late 2010, all but about \$300,000 of those reserves were spent on various projects by the previous general manager and Board. The result was that by early 2011, the District was no longer creditworthy to borrow funds and was denied even a small short term line of credit by several banks. In addition, the prior Board committed the District to an additional \$7 million in future cash payments (over the next 25-years) by entering into a series of contracts just prior to the new Board taking office.

To rectify the financial distress that the District was in, this Board set about on two simultaneous courses: one – reduce spending and two – increase revenue by raising ratepayers cost for water and sewer.

Here are some of the highlights used to reduce spending: In fiscal year 2011, the District cut nearly \$800,000 from the District's operating and maintenance budget, eliminated two full time positions, reduced staff hours and with the assistance and generous cooperation of the staff reduced or eliminated many other operating expenses. The Board, working with staff, renegotiated several contracts, reducing or eliminating a large portion of the \$7 million in future liabilities. We contracted out maintenance of the Club Circle Golf course to a local business and working with auditors, cleared the District's books of significant liabilities. In Fiscal year 2011, according to our audited financials, the District's cash and cash equivalents decreased by \$1,695,187. To further reduce legal and professional fees, each member of the Board put their individual professional skills to work on behalf of the District.

Additionally, we put off as many capital spending projects as practical and hired a consulting engineer to come up with a 10 year capital improvement plan that put off any debt financed improvements until the District has the free cash flow and

reserves necessary to be creditworthy again and to borrow money at a reasonable interest rate.

These efforts didn't end in 2011, but continued throughout Fiscal Year 2012. The staff and employees worked diligently to control costs and as a result, the District spent a hundred thousand dollars less than originally budgeted for its Operations and Maintenance expenses. We as a Board are very proud of our employees. Their efforts on your behalf are not just commendable, but without their earnest efforts, our ability to provide safe drinking water and sewer services would be severely affected.

The second course was to raise water and sewer rates. As most of you know, beginning in 2006, Proposition 218 was applied to the District requiring public notice, opportunity for comment and a right of protest before a District may raise rates. Because of our complicated financial problems, the Board hired a nationally known consulting firm, Raftelis Financials, to develop a plan to restore the District to financial stability. Their analysis determined that the District required an immediate 100% rate increase to return the District to credit worthiness in a reasonable time frame.

The Board recognized that to do so would create too great a burden on ratepayers and so with input from various community members who participated in meetings with the consultant and Board, the District proposed to raise rates 30% in 2011, 30% in 2012, 10% in 2013, 10% in 2014 and 5% in 2015. It was determined that with this schedule of increases, the District would be restored to both fiscal stability and credit worthiness by 2016 or 17. To secure the legal right to impose the increases, the District initiated the Proposition 218 process in June 2011 and having successfully secured community support, raised rates in 2011 by 30%.

I am using percentages as a simple way to explain the rate changes. The percentage of change was not the same for all users in 2011 because the base rate and commodity charge for water and sewer service was slightly different in each service area and the rate increase was authorized in actual dollar amounts, not a percentage. For more specific information, please visit our website or call and talk to staff in our office.

The increase in income from last year combined with the reduction in spending significantly improved the District's cash flow issues in Fiscal year 2012. We ended the year with slightly more cash on hand than we began with and that is good, very good.

But it did little to restore our credit worthiness which requires having both adequate free cash flow and monies in reserve (in savings) to meet the requirements of the bond rating agencies. During Board meetings in May and June, the District and public analyzed the District's situation to determine whether we should seek another 30% increase in rates as recommended by the District's financial consultant and allowed by Proposition 218, or something less. After much discussion, it was agreed that while an increase is required to build reserves and cover possible emergencies which would require the use of cash, we believe we can safely do so with only a 20% increase in rates this year.

There is a risk in seeking less than the financial consultant's recommendation, but the Board and District employees have worked diligently to reduce operations expenses and as a result, we will be putting into savings or reserve accounts about the same as if we had increased rates 30% rather than 20%. Barring equipment failures, emergencies or other serious events, we should be in better fiscal shape by next July than we were this July. And if something unforeseen should occur which significantly drains the District's cash, under Proposition 218, the Board may, at its discretion, raise rates again next year to the 20% level.

Speaking for the entire Board and the District's staff, we will continue to work to keep expenses as low as practical and manage the District's finances in a most prudent way so as to bring the very best value to ratepayers. We greatly appreciate all the support and assistance the community has provided as we have worked our way from a place of despair to a place of hope. We understand the financial pressure our decisions places on our community. But we are seeking to secure a future for this community that resolves its water issues in a beneficial manner and restores the District to financial integrity. That is our duty and our charge to you the ratepayers.