

# **Karegnondi Water Authority**

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**Financial Report**  
**September 30, 2014**

# **Karegnondi Water Authority**

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## Independent Auditor's Report

To the Board of Directors  
Karegnondi Water Authority

### **Report on the Financial Statements**

We have audited the accompanying basic financial statements of Karegnondi Water Authority, a component unit of Genesee County Water and Waste Services, from inception through the year ended September 30, 2014, and the related notes to the financial statements.

### ***Management's Responsibility for the Financial Statements***

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

### ***Auditor's Responsibility***

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

To the Board of Directors  
Karegnondi Water Authority

**Opinion**

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of Karegnondi Water Authority from inception through September 30, 2014 and the changes in its financial position and its cash flows thereof for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

**Other Matters**

*Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, as identified in the 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, which 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.

*Plante & Moran, PLLC*

March 17, 2015

# Karegnondi Water Authority

## Management's Discussion and Analysis

The Karegnondi Water Authority (KWA) was incorporated in October, 2010 pursuant to Act 233, Public Acts of Michigan, 1955, as amended, by the County of Genesee ("Genesee Co."), the County of Lapeer, the County of Sanilac, the City of Flint ("Flint"), and the City of Lapeer for the purpose of providing its member communities with a new source of water for treatment and distribution. This new water source will come from a Water Supply System (the "System") which is currently being constructed. The System will use Lake Huron as its source.

The System is expected ultimately to supply raw water for the three-county area consisting of over 2,200 square miles and a population of over one half million residents, but the System will initially provide raw water primarily to residents in Flint and Genesee Co. Currently, Genesee Co. receives finished water from the City of Detroit, through its Detroit Water and Sewerage Department (DWSD). Flint, which received water from DWSD through April 2014, is temporarily using and treating water from the Flint River. Genesee Co. and Flint participated in the establishment of the KWA in order to have a more reliable supply of water and long-term stabilization of rates.

The KWA will supply metered, untreated water to contracting members who will in turn be responsible for treating and distributing treated water to their individual customers. The actual cost for administration, operation, and maintenance of the System will be allocated based on water sold, and each contracting member will be responsible for its proportional share of these costs.

The KWA currently has entered into two Water Purchase Contracts (the "Contracts") effective October 1, 2013: one with Flint to supply up to 18 million gallons per day (mgd), and one with the Genesee County Drain Commissioner, as County Agency of Genesee Co. under Act 342, Public Acts of Michigan, 1939, as amended (the "County Agency"), on behalf of Genesee Co., to supply up to 42 mgd. The charges to be paid by Flint and the County Agency in the Contracts are broken down into two distinct portions: an annual fixed or capital fee and an annual commodity or operations and maintenance fee. Flint and the County Agency expect to pay such charges from the revenues of their respective water supply systems as an operation and maintenance expense in the same manner that each paid or presently pays for water furnished by DWSD.

The size of the System is based on the volume identified in the above Contracts. Each contracting party is responsible for the annual fixed fee regardless of the amount of water taken. The other members of the KWA had until October 16, 2013 to enter into a water purchase contract with the KWA at the same rates set forth in the Contracts. No additional water purchase contracts were entered into on or before that date and as a result, members entering into water purchase contracts with the KWA subsequent to that date will pay all incremental costs associated with accommodating their water purchase contracts.

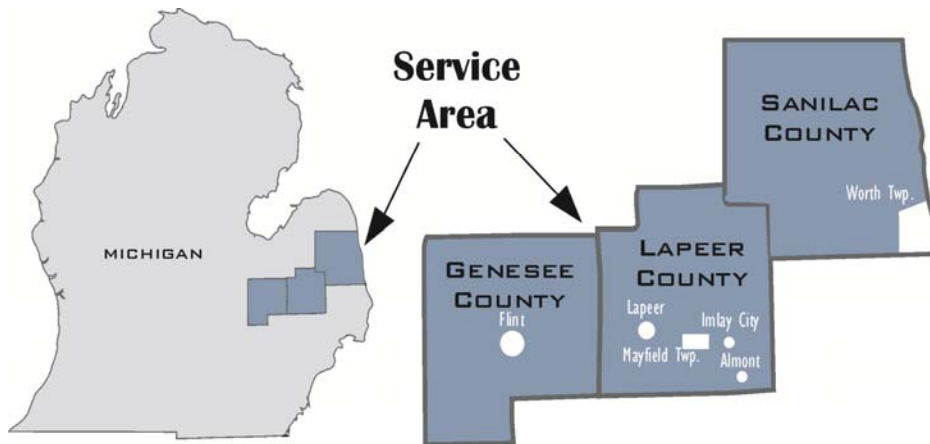
# Karegnondi Water Authority

## Management's Discussion and Analysis (Continued)

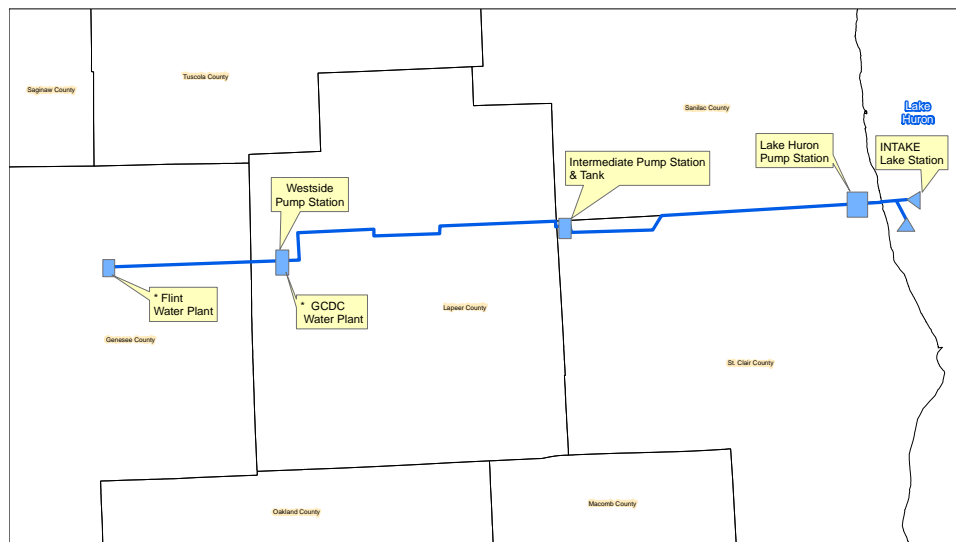
### The System

To supply water to its contracting members, the KWA is constructing a lake intake on Lake Huron, approximately 63 miles of pipe from the intake to the City of Flint, and three pump stations. These facilities collectively constitute the System. The engineering design of the System is to withdraw water from Lake Huron and pump it to a standpipe in Lynn Township in St. Clair County, and from there the water will be re-pumped to a site in Oregon Township in Lapeer County, approximately 14 miles east of Flint. That site will feature a 125 million gallon reservoir (also known as an impoundment) and the County Agency's new water treatment plant. The impoundment and new treatment plant will be owned and operated by the County Agency. A third pump station will continue to pump untreated water from the County Agency's site to Flint's water treatment plant. Figure 1 shows the location of the System facilities, the Flint water treatment plant, and the County Agency treatment plant and impoundment.

Figure 1



\*KWA and Customer Infrastructure



# **Karegnondi Water Authority**

## **Management's Discussion and Analysis (Continued)**

The intake facility and property were financed through the issuance of bonds by the Genesee Co. Agency in the principal amount of \$35,000,000 in October 2013, with the understanding that the County Agency would make the intake and property available to the KWA for use by the KWA as part of the System. Genesee Co. is solely responsible for paying the principal of and interest on these bonds from the net revenues derived from its users. Genesee Co. has pledged its limited tax full faith and credit as additional security for the bonds. The lake intake is currently under construction. The County Agency supervised the design of the facility and the receipt and award of construction bids for the facility. The lake intake is expected to be completed in 2015.

The KWA has retained the services of the County Agency to administer the design and construction of the System. The County Agency provided these services at no cost to the KWA since its inception through September 2014. In October 2014, the KWA began paying the County Agency \$3,000.00 monthly for these services. In addition, it is expected that the KWA will also contract with the County Agency for operation and maintenance of the System after the System is completed and fully operational. The County Agency has significant experience in planning, operating and managing water and wastewater systems, having been responsible for planning, operating and managing its own system since 1966. The County Agency currently employs approximately 128 people in connection with the operation and management of its current system, and it is expected that from this group, five full-time equivalent employees will be involved in the operation and maintenance of the System. The KWA is not expected to have any employees.

On behalf of the KWA, the County Agency has acquired 40 acres of land with 100 feet of frontage on Lake Huron in Sanilac County for the intake plant and first pump station, and 40 acres of land on the northwest corner of Martin Road and Hull Road in Lynn Township in St. Clair County for the standpipe and second pump station. The County Agency has also acquired approximately 80 acres of land on the northeast corner of Marathon Road and Stanley Road in Oregon Township in Lapeer County to serve as the site for the County Agency's new water treatment plant, reservoir, and the Westside Pump Station.

In anticipation of the construction of the System, the County Agency previously obtained a permit from the Michigan Department of Environmental Quality ("MDEQ") authorizing the withdrawal of up to 85 mgd from Lake Huron. In addition, the County Agency has hired project managers which have to date secured the route of the pipe line, identified all environmental issues and obtained preliminary permits for the entire 63-mile route, and retained consulting firms to complete the design of the remaining System facilities. At this time, the intake, the first two pumping stations, and portions of the pipeline are under construction.

# Karegnondi Water Authority

## Management's Discussion and Analysis (Continued)

The County Agency commissioned the design of the three pump stations and 63 miles of pipeline (36" to 66" in size). The design and construction were broken up into eight individual projects as follows:

- Lake Huron Pump Station
  - 12 miles of 66-inch transmission main
  - 12 miles of 66-inch transmission main
- Intermediate Pump Station and Standpipe
  - 12 miles of 60-inch transmission main
  - 13 miles of 60-inch transmission main
- Westside Pump Station
  - 14 miles of 36-inch transmission main

The System facilities call for 63 miles of large diameter piping, and the KWA recognized that with limited capacity in the United States to produce the needed materials within the necessary time frame for construction, alternative methods of procurement would be required. In 2013, the KWA requested proposals for large diameter piping and valves, and in October 2013, the KWA entered into a contract with American Cast Iron Pipe Company (ACIPCO) for the delivery of all 66-inch diameter, 60-inch diameter, and 36-inch diameter pipe. In addition, ACIPCO is providing all large-diameter valves for the pipeline and pump station yard piping, valves, and hydrants.

The design of the pipelines is 100 percent complete. The pipelines were bid in a staggered format beginning in April 2014 through September 2014. Each contract was awarded within two months of bid opening. A contractor needs approximately 15 months of good weather to complete each pipeline segment.

The design of the first two pump stations was also completed, and contracts were awarded during 2014. With a 22-month construction schedule for the Lake Huron and Intermediate pump stations, they are expected to be completed by May 2016.

Based upon the foregoing, the System is expected to be available for service no later than July 31, 2016. Each contract identifies substantial completion (operation of the pipeline) and final completion (pipeline, clean-up, and paperwork). The County Agency can begin operation of the pipeline on behalf of the KWA after substantial completion but prior to final completion.



# **Karegnondi Water Authority**

## **Management's Discussion and Analysis (Continued)**

The estimated construction costs for the System, including the lake intake and site financed by the County Agency, are approximately \$269,000,000 based on water purchase contracts of 60 mgd. The KWA and the Local Units have entered into contracts, whereby the KWA has agreed to issue bonds in an aggregate amount not to exceed \$300,000,000 (collectively, the "System Bonds"), to finance the remaining facilities for the System in anticipation of the Contractual Payments to be made by the Local Units as provided therein. The Contract is contemplated in the Water Purchase Contracts and sets forth the manner in which the capital costs of the System facilities will be allocated. Under the Contracts, Flint and the County Agency are responsible for paying approximately 34.2% and 65.8%, respectively, of the debt service on the System Bonds. This allocation takes into account and credits the County Agency for financing and being responsible for the payment of 100% of the costs of the Intake. In addition, Genesee Co. has pledged its limited tax full faith and credit to 100% of the debt service on the System Bonds.

### **Interim Water Supply Arrangements for Genesee Co. and Flint**

Flint had purchased treated water from DWSD for approximately 30 years, during which time the County Agency had a contract with Flint that required Flint to purchase water from DWSD and provide that water to the County Agency. Flint is currently using the Flint River as a temporary water source, while the County Agency is purchasing treated water directly from DWSD.

### **Related Facilities**

In order to provide finished water to its customers, Flint made numerous upgrades to its existing water treatment plant (which had been operating in a back-up only role) and is currently permitted to treat water drawn from the Flint River until the System is operational. In order to provide finished water to Genesee Co. customers, the County Agency will be required to build a new water treatment plant, reservoir, and approximately five miles of watermain running from the new treatment plant to the County Agency's main distribution facility at Henderson Road, at an estimated cost of \$80,000,000.

The completion date for the System is projected for no later than July 31, 2016, at which time Flint expects to cease treating water from the Flint River, and will begin purchasing and treating water from the KWA. Once the County Agency completes its water treatment plant and associated pipeline in 2017, it will discontinue purchasing water from DWSD, and will also begin purchasing and treating water from the KWA.

### **Objectives**

The main objectives of the KWA are to build and maintain a high quality water delivery system at rates which will be fair and cost-effective to all concerned. And in accordance with its bylaws, the KWA maintains a yearly budget of income and expenses. The budget is reviewed and approved by the KWA board.

# Karegnondi Water Authority

## Management's Discussion and Analysis (Continued)

### Using this Annual Report

This annual report consists of a series of financial statements. The statement of net position, the statement of revenues, expenses, and changes in net position, and the statement of cash flows provide information about the activities of the KWA as a whole and assist in presenting a longer-term view of its finances. As the fiscal year ending September 30, 2014 marked the first year of KWA operations there is no year vs. year comparison data.

### Major Capital Assets and Debt Activity

Construction began in 2014 with construction in progress spending totaling \$29,378,922 through September 30, 2014. When netted with interest received on all construction fund investments of \$132,919, plus bond amortization costs of \$393,851, and the capital lease on the intake, construction in progress on September 30, 2014 totaled \$60,169,807.

The KWA sold \$220,500,000 par value in water system supply bonds in April 2014. Sources and uses of funds were as follows:

#### *Sources of Funds*

Par amount of Bonds	\$220,500,000.00
Net Original Issue Premium/Discount	<u>11,815,544.05</u>
Total Sources	<u>\$232,315,544.05</u>

#### *Use of Funds*

Deposit to Construction Fund - Initial	\$187,137,367.59
Deposit to Construction Fund - Subsequent	8,606.00
Capitalized Interest	28,282,364.06
Deposit to Debt Service Reserve Account	15,237,437.50
Costs of Issuance	703,394.00
Underwriters' Discount	<u>946,374.90</u>
Total Uses	<u>\$232,315,544.05</u>

### Operating Revenues

The KWA's two water purchase customers, the City of Flint and the Genesee County Drain Commissioner as County Agency, have made 100% of their water supply contract operating subsidy good faith payments on time. These operating subsidies totaled \$3,714,500 in fiscal year 2014, and are expected to total \$1,938,000 in fiscal year 2015.

### Contacting Management

This financial report is intended to provide our constituents, future water users, and bondholders with a general overview of the Karegnondi Water Authority's accountability for the money it receives. If there are questions about this report or if additional information is needed, we welcome you to contact the CEO.

# Karegnondi Water Authority

## Statement of Net Position September 30, 2014

### Assets

Current assets:	
Cash and cash equivalents (Note 2)	\$ 3,587,535
Receivables:	
Accrued interest receivable	32,667
Bond proceeds receivable	<u>4,679,146</u>
Total current assets	8,299,348
Noncurrent assets:	
Restricted assets (Note 3)	176,961,787
Capital assets - Assets not subject to depreciation (Note 4)	60,169,807
Deposit with pipe supplier	<u>33,960,593</u>
Total noncurrent assets	<u>271,092,187</u>
Total assets	279,391,535

### Liabilities

Current liabilities - Accounts payable	2,808
Noncurrent liabilities:	
Payable from restricted assets (Note 1)	10,600,077
Long-term debt (Note 5)	<u>266,921,693</u>
Total noncurrent liabilities	<u>277,521,770</u>
Total liabilities	277,524,578

### Equity

Net position:	
Net investment in capital assets	(1,750,437)
Unrestricted	<u>3,617,394</u>
Total net position	<u>\$ 1,866,957</u>

# Karegnondi Water Authority

## Statement of Revenues, Expenses, and Changes in Net Position Year Ended September 30, 2014

<b>Operating Revenue</b> - Sales of plans	\$ 4,915
<b>Operating Expenses</b>	
Office supplies and insurance	6,112
Professional services	132,981
	<hr/>
Total operating expenses	139,093
<b>Operating Loss</b>	(134,178)
<b>Nonoperating Revenue (Expenses)</b>	
Water supply contract operating subsidy	3,714,500
Interest expense	(137,044)
Bond issuance costs	(1,717,769)
Investment income	141,448
	<hr/>
Total nonoperating revenue	2,001,135
<b>Change in Net Position</b>	1,866,957
<b>Net Position</b> - Beginning of year	<hr/> -
<b>Net Position</b> - End of year	<hr/> <b>\$ 1,866,957</b> <hr/>

# Karegnondi Water Authority

## Statement of Cash Flows Year Ended September 30, 2014

<b>Cash Flows from Operating Activities</b>	
Receipts from customers	\$ 4,915
Payments to suppliers	<u>(136,285)</u>
Net cash used in operating activities	(131,370)
<b>Cash Flows from Noncapital Financing Activities - Water supply contract operating subsidy</b>	3,714,500
<b>Cash Flows from Capital and Related Financing Activities</b>	
Proceeds from issuance of bonded debt	232,315,544
Deposit with pipe supplier	(33,960,593)
Purchase of capital assets	(19,779,771)
Bond issuance costs	<u>(1,717,769)</u>
Net cash provided by capital and related financing activities	176,857,411
<b>Cash Flows from Investing Activities</b>	
Investment income	108,781
Purchase of investment securities	<u>(163,553,205)</u>
Net cash used in investing activities	<u>(163,444,424)</u>
<b>Net Increase in Cash and Cash Equivalents</b>	16,996,117
<b>Cash and Cash Equivalents - Beginning of year</b>	<u>-</u>
<b>Cash and Cash Equivalents - End of year</b>	<u><b>\$ 16,996,117</b></u>
<b>Balance Sheet Classification of Cash and Cash Equivalents</b>	
Cash and cash equivalents	3,587,535
Restricted assets	176,961,787
Less amounts classified as investments	<u>(163,553,205)</u>
Total cash and cash equivalents	<u><b>\$ 16,996,117</b></u>
<b>Reconciliation of Operating Loss to Net Cash from Operating Activities</b>	
Operating loss	\$ (134,178)
Changes in assets and liabilities - Accounts payable	<u>2,808</u>
Net cash used in operating activities	<u><b>\$ (131,370)</b></u>

# Karegnondi Water Authority

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## Notes to Financial Statements September 30, 2014

### Note I - Summary of Significant Accounting Policies

The following is a summary of the significant accounting policies used by Karegnondi Water Authority (KWA or the "Authority"):

#### **Reporting Entity**

Karegnondi Water Authority is governed by an appointed 15-member board and was created pursuant to Act 233, Michigan Public Acts of 1955. Its purpose is to acquire and operate a water pipeline that provides water to the Genesee County Drain Commission and the City of Flint, which in turn will treat the water to be provided to their residents. The Authority may also provide water to other local units in Lapeer and Sanilac counties. The Genesee County Drain Commissioner has financial accountability for KWA. This is subject to change based upon redistribution of capacity units.

#### **Accounting and Reporting Principles**

The Authority follows accounting principles generally accepted in the United States of America (GAAP) as applicable to governmental units. Accounting and financial reporting pronouncements are promulgated by the Governmental Accounting Standards Board.

#### **Fund Accounting**

The Authority accounts for its various activities in an enterprise fund, in order to demonstrate accountability for how we have spent certain resources.

**Proprietary Fund** - Includes an enterprise fund, which provide goods or services to users in exchange for charges or fees. The Authority only has one fund, the Water Fund, which will provide water to customers through a pipeline to be constructed from Lake Huron. The pipeline is currently under construction and water is expected to be delivered subsequently.

#### **Basis of Accounting**

Proprietary funds use the economic resources measurement focus and the full accrual basis of accounting. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

#### **Report Presentation**

This report includes the fund-based statements of the Authority. In accordance with government accounting principles, a government-wide presentation with program and general revenues is not applicable to special purpose governments engaged only in business-type activities.

# Karegnondi Water Authority

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## Notes to Financial Statements September 30, 2014

### Note I - Summary of Significant Accounting Policies (Continued)

#### Specific Balances and Transactions

**Cash and Cash Equivalents** - Cash and cash equivalents include cash on hand, demand deposits, and short-term investments with a maturity of three months or less when acquired.

**Investments** - Investments are reported at fair value or estimated fair value. Short-term investments are reported at cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates.

**Prepaid Items** - Certain payments to vendors reflect costs applicable to future fiscal years and are recorded as prepaid items in the fund financial statements.

**Restricted Assets** - The Authority's bond indenture requires amounts to be set aside in a construction account and a debt service reserve. These amounts have been classified as restricted assets, as well as amounts on deposit at the county being held for the construction or debt service of Karegnondi Water Authority water lines.

**Liabilities Payable from Restricted Assets** - The portion of interest due within the next year will be payable from these restricted assets and therefore has been reported as a noncurrent liability. The construction accounts payable will also be liquidated from the construction account and has been reported in this category.

**Capital Assets** - Capital assets are defined by the Authority as assets with an initial individual cost of more than \$1,000 and an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation. Currently, the Authority is in the process of constructing a water transmission line from Lake Huron; these costs are being reported as construction in progress during construction, after which time they will be depreciated over their estimated useful lives.

Interest incurred during the construction of capital assets of business-type activities is included as part of the capitalized value of the assets constructed. During the current year, \$5,029,289 of interest expense was capitalized as part of the cost of assets under construction.

**Long-term Obligations** - Bond premiums are deferred and amortized over the life of the bonds using the effective interest method; bonds payable are reported net of the applicable bond premium. Bond issuance costs are expensed at the time they are incurred.

# Karegnondi Water Authority

## Notes to Financial Statements September 30, 2014

### Note 1 - Summary of Significant Accounting Policies (Continued)

**Net Position Flow Assumption** - Sometimes the government will fund outlays for a particular purpose from both restricted (e.g., restricted bond or grant proceeds) and unrestricted resources. In order to calculate the amounts to report as restricted - net position and unrestricted - net position in the government-wide and proprietary fund financial statements, a flow assumption must be made about the order in which the resources are considered to be applied. It is the government's policy to consider restricted - net position to have been depleted before unrestricted - net position is applied.

**Proprietary Funds Operating Classification** - Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the water fund are charges to customers for sales and services. Operating expenses for enterprise fund include the cost of sales and services and administrative expenses. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

**Use of Estimates** - The preparation of financial statements in conformity with accounting principles generally accepted 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 revenue and expenses during the period. Actual results could differ from those estimates.

### Note 2 - Deposits and Investments

Deposits and investments are reported in the financial statements as follows:

Cash and cash equivalents	\$ 3,587,535
Restricted assets	<u>176,961,787</u>
Total	<u>\$ 180,549,322</u>

These amounts are classified into the following deposits and investment categories:

	Primary Government
Deposits with financial institutions	\$ 60,549,322
Investments - Repurchase agreements (with maturities in excess of 90 days)	<u>120,000,000</u>
Total	<u>\$ 180,549,322</u>



# Karegnondi Water Authority

## Notes to Financial Statements September 30, 2014

### Note 2 - Deposits and Investments (Continued)

Michigan Compiled Laws Section 129.91 (Public Act 20 of 1943, as amended) authorizes local governmental units to make deposits and invest in the accounts of federally insured banks, credit unions, and savings and loan associations that have offices in Michigan. The law also allows investments outside the State of Michigan when fully insured. The local unit is allowed to invest in bonds, securities, and other direct obligations of the United States or any agency or instrumentality of the United States; repurchase agreements; bankers' acceptances of United States banks; commercial paper rated within the two highest classifications, which mature not more than 270 days after the date of purchase; obligations of the State of Michigan or its political subdivisions, which are rated as investment grade; and mutual funds composed of investment vehicles that are legal for direct investment by local units of government in Michigan.

The Authority has designated three banks for the deposit of its funds. The investment policy adopted by the board in accordance with Public Act 196 of 1997 has authorized investment in bonds and securities of the United States government and bank accounts and CDs, but not the remainder of state statutory authority as listed above. The Authority's deposits and investment policies are in accordance with statutory authority.

The Authority's cash and investments are subject to several types of risk, which are examined in more detail below:

**Custodial Credit Risk of Bank Deposits** - Custodial credit risk is the risk that in the event of a bank failure, the Authority's deposits may not be returned to it. The Authority does not have a deposit policy for custodial credit risk. At year end, the Authority had no bank deposits (certificates of deposit, checking and savings accounts) that were not fully insured or collateralized.

**Custodial Credit Risk of Investments** - Custodial credit risk is the risk that, in the event of the failure of the counterparty, the Authority will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Authority does not have a policy for custodial credit risk. At year end, \$120,000,000 of investment securities were uninsured and unregistered, with securities held by the counterparty or by its trust department or agent but not in the Authority's name.

<u>Investment Type</u>	<u>Carrying Value</u>	<u>How Held</u>
Repurchase agreements	\$ 120,000,000	Agent

# Karegnondi Water Authority

## Notes to Financial Statements September 30, 2014

### Note 2 - Deposits and Investments (Continued)

**Interest Rate Risk** - Interest rate risk is the risk that the value of investments will decrease as a result of a rise in interest rates. The Authority's investment policy does not restrict investment maturities, other than commercial paper which can only be purchased with a 270-day maturity.

At year end, the Authority had the following investments:

Investment	Fair Value	Weighted Average Maturity (Years)
<b>Authority</b>		
Repurchase Agreement	\$ 120,000,000	.71

**Concentration of Credit Risk** - The Authority places no limit on the amount it may invest in any one issuer. More than 73 percent of the Authority's investments are in a repurchase agreement with Duetche Bank; these investments are 73 percent of the Authority's total investments.

### Note 3 - Restricted Assets

The restricted assets are restricted for the following purposes:

Unspent bond proceeds and related interest	\$ 133,237,608
County deposits	100,000
General obligation bond restrictions:	
Debt reserve	15,341,815
Debt retirement	<u>28,282,364</u>
Total restricted assets	<u>\$ 176,961,787</u>

### Note 4 - Capital Assets

Capital asset activity of the Authority's business-type activities was as follows:

Business-type Activities	Balance October 1, 2013	Additions	Disposals	Balance September 30, 2014
Capital assets not being depreciated -				
Construction in progress	\$ -	\$ 60,169,807	\$ -	\$ 60,169,807

# Karegnondi Water Authority

## Notes to Financial Statements September 30, 2014

### Note 4 - Capital Assets (Continued)

**Construction Commitments** - The Authority has active construction projects at year end. The project is to complete the water pipeline. At year end, the Authority's commitments with contractors are as follows:

	<u>Spent to Date</u>	<u>Remaining Commitment</u>
Water pipeline	\$ 28,443,815	\$ 205,515,229

### Note 5 - Long-term Debt

The Authority issues bonds to provide for the acquisition and construction of major capital facilities. General obligation bonds are direct obligations and pledge the full faith and credit of the Authority.

Description	<u>Amount</u>				
<b>Business-type Activities</b>					
General Obligations -					
2014A Water supply system bond, used to construct water pipeline, bearing interest from 3% to 5.25%, maturing in 2043				\$	220,500,000
	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
<b>Business-type Activities</b>					
Bonds	\$ -	\$220,500,000	\$ -	\$220,500,000	\$ -
Plus deferred amounts - Issuance premiums	-	11,815,544	393,851	11,421,693	393,851
Total bonds payable	\$ -	\$232,315,544	\$ 393,851	\$231,921,693	\$ 393,851
Capital lease (Note 6)	-	35,000,000	-	35,000,000	-
Total business-type activities	<u>\$ -</u>	<u>\$267,315,544</u>	<u>\$ 393,851</u>	<u>\$266,921,693</u>	<u>\$ 393,851</u>

# Karegnondi Water Authority

## Notes to Financial Statements September 30, 2014

### Note 5 - Long-term Debt (Continued)

Total interest expense for the year was \$5,166,333, of which \$5,033,414 (interest expense net of interest income) was capitalized. Annual debt service requirements to maturity for the above bonds and note obligations are as follows:

Year Ending September 30	Business-type Activities		
	Principal	Interest	Total
2015	\$ -	\$ 11,591,133	\$ 11,591,133
2016	-	11,127,488	11,127,488
2017	2,052,500	11,127,488	13,179,988
2018	4,190,000	11,044,863	15,234,863
2019	4,375,000	10,861,863	15,236,863
2020-2024	24,960,000	51,213,440	76,173,440
2025-2029	31,715,000	44,461,015	76,176,015
2030-2034	40,847,500	35,328,132	76,175,632
2035-2039	52,425,000	23,752,782	76,177,782
2040-2044	59,935,000	8,624,869	68,559,869
Total	<u>\$ 220,500,000</u>	<u>\$ 219,133,073</u>	<u>\$ 439,633,073</u>

# Karegnondi Water Authority

## Notes to Financial Statements September 30, 2014

### Note 6 - Capital Lease

**Capital Leases** - The Authority has entered into a lease agreement as lessee for financing the purchase of the intake pump station. This lease agreement qualifies as a capital lease for accounting purposes and, therefore, has been recorded at the present value of the future minimum lease payments as of the inception date. The future minimum lease obligations and the net present value are as follows:

<u>Years Ending September 30</u>	<u>Amount</u>
2015	\$ 2,529,423
2016	2,526,837
2017	2,527,388
2018	2,527,188
2019	2,527,588
2020-2024	12,636,337
2025-2029	12,639,975
2030-2034	12,632,175
2035-2039	12,637,343
Total minimum lease payments	63,184,254
Less amount representing interest	<u>(28,184,254)</u>
Present value	<u>\$ 35,000,000</u>

### Note 7 - Water Supply Contract Operating Subsidy

Understanding that the goal of the Authority is to provide water to both the City of Flint and Genesee County Drain Commission (local units), the local units have agreed to pay the Authority a good faith payment equal to \$32,300 per unit of water that the local unit has contractually agreed to purchase once the pipeline is fully operational. The City of Flint and Genesee County Drain Commission have contractually agreed to purchase 18 and 42 units, respectively, on a yearly basis. The yearly good faith payment will be paid through monthly installments and is expected to bring cash flows of \$1,938,000 to the Authority. When the pipeline becomes fully operational, the monthly payments will be suspended and the contract with the local units indicates that a credit will be given on their monthly bills to return the funds contributed to the Authority. The terms of the repayment will be decided by the Board of Directors at the time that the pipeline is operational; however, the funds must be repaid within a maximum of 40 years.

# **Karegnondi Water Authority**

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## **Notes to Financial Statements September 30, 2014**

### **Note 8 - Related Party Transactions**

The bonds of the Karegnondi Water Authority are guaranteed through 2043 by both Genesee County and the City of Flint in the amounts of 66 percent and 34 percent, respectively, in accordance with the Karegnondi Water Authority Financing Contract. The Genesee County Division of Water and Waste Services provides management of the day-to-day operations of the Karegnondi Water Authority, for which it allocates a portion of the costs to the Authority. Water and Waste Services has also issued \$35 million of bonds that it is using to construct the water intake and related pumps that KWA will use to bring water into its pipes to be transmitted to the water treatment plants by the City of Flint and the Division of Water and Waste Services. Once the bonds are redeemed, the title to the water intake and related pumps will be transferred to KWA.