

Karegnondi Water Authority

Financial Report
September 30, 2017

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 (the "Authority"), a component unit of Genesee County Water and Waste Services, as of and for the years ended September 30, 2017 and 2016 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 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 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 as of September 30, 2017 and 2016 and the changes in its financial position and its cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matter

Required Supplemental 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 supplemental 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

February 6, 2018

Karegnondi Water Authority

Management's Discussion and Analysis

Karegnondi Water Authority (KWA or the "Authority") was incorporated in October 2010 pursuant to Act 233, Public Acts of Michigan, 1955, as amended, by the County of Genesee, Michigan (Genesee Co.), the County of Lapeer, Michigan, the County of Sanilac, Michigan, the City of Flint, Michigan (Flint), and the City of Lapeer, Michigan for the purpose of providing its member communities with a new source of water for treatment and distribution. This new water source comes from a Water Supply System (the "System") which has been recently completed. The System delivers Lake Huron water to its customers.

The System is currently providing untreated water to the Genesee County Drain Commissioner (the "County Agency") as its primary water source pursuant to the Genesee Water Purchase Contract. Under a contract with Flint (the "Flint Water Purchase Contract"), Flint has the right to the delivery and use of up to 18 million gallons per day of untreated water. Under a long-term water supply contract entered into by Flint and the Great Lakes Water Authority (GLWA) as of December 1, 2017 (the "GLWA Water Service Contract"), GLWA will supply Flint with treated water as its primary water source for an initial period of 30 years. Pursuant to the terms of the GLWA Water Service Contract, Flint has granted to GLWA certain rights of Flint under the Flint Water Purchase Contract to untreated water from the System.

The System

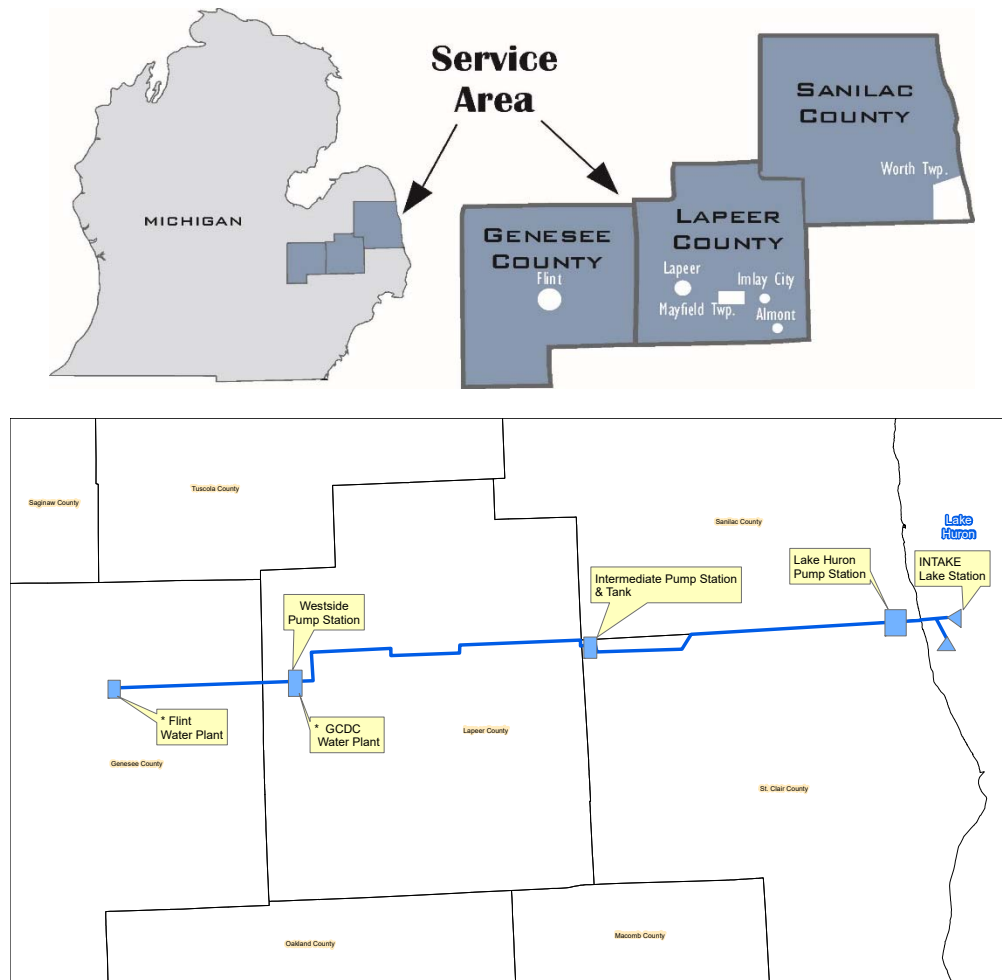
To supply water to its contracting members, KWA constructed two lake intakes in Lake Huron, approximately 63 miles of pipe from the intake to the City of Flint, and three pump stations. These facilities collectively constitute the System. The engineering design of the System was to withdraw water from Lake Huron and pump it to a standpipe in Lynn Township in St. Clair County, and from there, repump the water to a site in Oregon Township in Lapeer County, approximately 14 miles east of Flint. That site features a 125 million gallon reservoir (also known as an impoundment) which was completed in 2016, along with the County Agency's new water treatment plant which was completed in June 2017.

The impoundment and new treatment plant are owned and operated by the County Agency. A third pump station is capable to pump untreated water from the County Agency's site to Flint's water treatment plant. Figure 1 shows the location of the System's facilities, the Flint water treatment plant, and the County Agency treatment plant and impoundment.

Karegnondi Water Authority

Management's Discussion and Analysis (Continued)

Figure 1



The intake facility and property were financed through the issuance of bonds by the County 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 KWA for use by KWA as part of the System. The County Agency is solely responsible for paying the principal of and interest on these bonds from the net revenue derived from its users. Genesee County has pledged its limited tax full faith and credit as additional security for the bonds.

The lake intake construction and testing were completed in 2016. The County Agency has entered into an agreement which calls for the ownership of the intake to be transferred to KWA once the intake debt has been retired.

Karegnondi Water Authority

Management's Discussion and Analysis (Continued)

KWA 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 KWA since its inception through September 2014. In October 2014, KWA began paying the County Agency \$3,000.00 monthly for these services. Then in June 2017, after the system was completed and operational, KWA contracted with the County Agency for operation and maintenance of the System. 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 150 people in connection with the operation and management of its current system, and from this group, approximately five full-time-equivalent employees are involved in the operation and maintenance of the System. KWA does not have any employees.

Objectives

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

Using this Annual Report

This annual report consists of a series of financial statements. The statement of net position, the statement of revenue, expenses, and changes in net position, and the statement of cash flows provide information about the activities of KWA as a whole and assist in presenting a longer-term view of its finances.

Karegnondi Water Authority

Management's Discussion and Analysis (Continued)

Condensed Financial Information

The following tables present condensed information about the Authority's financial position compared to the prior two years:

	September 30			(Decrease) Increase	Percent Change
	2015	2016	2017		
Assets					
Current assets	\$ 5,603,627	\$ 7,267,552	\$ 6,197,784	\$ (1,069,768)	-15%
Restricted assets	108,590,629	45,429,465	39,968,773	(5,460,692)	-12%
Capital assets	181,395,807	310,377,287	331,427,489	21,050,202	7%
Total assets	295,590,063	363,074,304	377,594,046	14,519,742	4%
Liabilities					
Current liabilities	10,031	18,575	68,943,071	68,924,496	371061%
Liabilities payable from restricted assets	21,954,798	12,573,368	21,105,256	8,531,888	68%
Other noncurrent liabilities	3,428,607	5,118,032	5,258,648	140,616	3%
Long-term debt	266,527,841	340,503,990	260,770,138	(79,733,852)	-23%
Total liabilities	291,921,277	358,213,965	356,077,113	(2,136,852)	-1%
Net Position					
Net investment in capital assets	1,059,404	1,778,879	14,802,771	13,023,892	732%
Restricted for debt service	497,893	950,515	7,514,028	6,563,513	691%
Unrestricted	2,111,489	2,130,945	(799,866)	(2,930,811)	-138%
Total net position	\$ 3,668,786	\$ 4,860,339	\$ 21,516,933	\$ 16,656,594	343%

	Year Ended September 30			Change	Percent Change
	2015	2016	2017		
Operating Revenue - Sale of water	\$ -	\$ -	\$ 441,074	\$ 441,074	100%
Operating Expenses					
Office supplies and insurance	4,792	4,186	69,222	65,036	1554%
Utilities	-	-	289,743	289,743	100%
Repairs and maintenance	-	-	17,002	17,002	100%
Contractual and professional services	136,192	190,313	1,216,017	1,025,704	539%
Other expenses	-	-	4,854	4,854	100%
Total operating expenses	140,984	194,499	1,596,838	1,402,339	721%
Operating Loss	(140,984)	(194,499)	(1,155,764)	(961,265)	494%
Nonoperating Revenue (Expenses)					
Water supply contract operating subsidy	1,938,000	1,938,000	-	(1,938,000)	-100%
Capacity/Debt service fee	-	-	17,760,242	17,760,242	100%
Investment income	4,813	11,270	52,116	40,846	362%
Bond issuance costs	-	(563,218)	-	563,218	-100%
Total nonoperating revenue	1,942,813	1,386,052	17,812,358	16,426,306	1185%
Change in Net Position	\$ 1,801,829	\$ 1,191,553	\$ 16,656,594	\$ 15,465,041	1298%

Karegnondi Water Authority

Management's Discussion and Analysis (Continued)

Major Capital Assets and Debt Activity

KWA and the local units entered into a contract whereby KWA was authorized to issue bonds with a total par value not to exceed \$300,000,000 (collectively, the "System Bonds") to finance the 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's facilities would be allocated. Under the contracts, Flint and the County Agency are responsible for paying approximately 34 percent and 66 percent, 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 percent of the costs of the intake. In addition, Genesee County, Michigan pledged its limited tax full faith and credit to 100 percent of the debt service on the System Bonds.

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 - \$11,815,544.05
Total sources - \$232,315,544.05

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 - \$946,374.90
Total uses - \$232,315,544.05

KWA sold \$74,370,000 par value in water system supply bonds in June 2016.

Sources and uses of funds were as follows:

Sources of Funds

Par amount of bonds - \$74,370,000
Net original issue premium/discount - \$0.00
Total sources - \$74,370,000.00

Karegnondi Water Authority

Management's Discussion and Analysis (Continued)

Use of Funds

Deposit to construction fund - \$61,999,332.18
Capitalized interest - \$4,878,159.88
Deposit to debt service reserve account - \$6,954,939.94
Costs of issuance - \$223,680.50
Purchaser's fee - \$313,887.50
Total uses - \$74,370,000.00

KWA anticipates refinancing the 2016 \$74,370,000 par value bonds in 2018.

Financial Review

A discussion of the significant financial activity during the current year is as follows:

Statement of Net Position

- Cash and cash equivalents decreased from \$7,159,901 to \$5,877,667 primarily due to the increase in total operating expenses in the current year.
- Capital assets increased \$21,050,202 due to additional construction in progress related to the pipeline plus the year's capitalized interest cost.
- Payable from restricted assets increased by \$8,531,888 due to debt service payable from restricted assets becoming due and payable.
- Net position increased \$16,656,594. This increase is the result of KWA collecting the capacity/debt service fee from the County Agency and Flint to fund the capital-related debt service.

Statement of Revenue, Expenses, and Changes in Net Position

- Operating revenue was \$441,074 due to water sales beginning in July 2017. KWA began selling raw water to the County Agency so that the County Agency could begin testing of its new water treatment plant. Subsequent to year end, in November 2017, the County Agency began full operations of its water treatment plant and thereby increased purchases of raw water from KWA. Water sales are budgeted at approximately \$3,360,000 in 2018.
- Operating expenses increased \$1,402,339 due to KWA operating the system at a higher capacity for testing purposes as noted above. Operating expenses are budgeted at approximately \$2,950,000 in fiscal year 2018.
- KWA began invoicing the County Agency and Flint for debt service in fiscal year 2017, resulting in \$17,760,242 of nonoperating capacity/debt service fee revenue.
- Bond issuance costs decreased \$563,218 due to no new debt being issued during the year.

Karegnondi Water Authority

Management's Discussion and Analysis (Continued)

Contacting Management

This financial report is intended to provide our constituents, future water users, and bondholders with a general overview of 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 anyone to contact the CEO.

Karegnondi Water Authority

Statement of Net Position

	September 30, 2017	September 30, 2016
Assets		
Current assets:		
Cash and cash equivalents (Note 2)	\$ 5,877,667	\$ 7,159,901
Receivables:		
Accrued interest receivable	-	74,117
Other construction receivables (refunds)	81,409	-
Due from other governmental units	238,708	33,534
Total current assets	6,197,784	7,267,552
Noncurrent assets:		
Restricted assets (Note 3)	39,968,773	45,429,465
Capital assets - Assets not subject to depreciation (Note 4)	331,427,489	310,377,287
Total noncurrent assets	371,396,262	355,806,752
Total assets	377,594,046	363,074,304
Liabilities		
Current liabilities:		
Accounts payable - Operations	119,751	18,575
Accounts payable - Construction	1,537,842	-
Current portion of long-term debt	67,285,478	-
Total current liabilities	68,943,071	18,575
Noncurrent liabilities:		
Payable from restricted assets (Note 1)	21,105,256	12,573,368
Lease interest payable	5,258,648	5,118,032
Long-term debt (Note 5)	260,770,138	340,503,990
Total noncurrent liabilities	287,134,042	358,195,390
Total liabilities	356,077,113	358,213,965
Equity - Net position		
Net investment in capital assets	14,802,771	1,778,879
Restricted for debt service	7,514,028	950,515
Unrestricted	(799,866)	2,130,945
Total net position	<u>\$ 21,516,933</u>	<u>\$ 4,860,339</u>

Karegnondi Water Authority

Statement of Revenue, Expenses, and Changes in Net Position

	Years Ended	
	September 30, 2017	September 30, 2016
Operating Revenue - Changes for sales and services - Sale of water	\$ 441,074	\$ -
Operating Expenses		
Insurance expense	69,222	4,186
Repairs and maintenance	17,002	-
Utilities	289,743	-
Contractual and professional services	1,216,017	190,313
Other expenses	4,854	-
Total operating expenses	<u>1,596,838</u>	<u>194,499</u>
Operating Loss	(1,155,764)	(194,499)
Nonoperating Revenue (Expenses)		
Capacity/Debt service fee	17,760,242	-
Water supply contract operating subsidy	-	1,938,000
Bond issuance costs	-	(563,218)
Investment income	52,116	11,270
Total nonoperating revenue	<u>17,812,358</u>	<u>1,386,052</u>
Change in Net Position	16,656,594	1,191,553
Net Position - Beginning of year	<u>4,860,339</u>	<u>3,668,786</u>
Net Position - End of year	<u>\$ 21,516,933</u>	<u>\$ 4,860,339</u>

Karegnondi Water Authority

Statement of Cash Flows

	Years Ended	
	September 30, 2017	September 30, 2016
Cash Flows from Operating Activities		
Receipts from customers	\$ 202,366	\$ -
Payments to suppliers	(1,495,662)	(185,955)
Net cash used in operating activities	(1,293,296)	(185,955)
Cash Flows from Noncapital Financing Activities - Water supply contract operating subsidy	-	1,938,000
Cash Flows from Capital and Related Financing Activities		
Bond proceeds received	-	74,370,000
Capacity/Debt service fee	17,760,242	-
Purchase of capital assets	(9,353,924)	(126,489,885)
Interest paid on capital debt	(14,422,572)	(11,036,205)
Bond issuance costs	-	(563,218)
Net cash used in capital and related financing activities	(6,016,254)	(63,719,308)
Cash Flows from Investing Activities		
Investment income	566,624	569,415
Purchase of investment securities	(3,964,103)	-
Proceeds from sale and maturities of investment securities	-	68,908,919
Net cash (used in) provided by investing activities	(3,397,479)	69,478,334
Net (Decrease) Increase in Cash and Cash Equivalents	(10,707,029)	7,511,071
Cash and Cash Equivalents - Beginning of year	18,969,730	11,458,659
Cash and Cash Equivalents - End of year	\$ 8,262,701	\$ 18,969,730
Statement of Net Position Classification of Cash and Cash Equivalents		
Cash and cash equivalents	\$ 5,877,667	\$ 7,159,901
Restricted assets	39,968,773	45,429,465
Less amounts classified as investments	(37,583,739)	(33,619,636)
Total cash and cash equivalents	\$ 8,262,701	\$ 18,969,730
Reconciliation of Operating Loss to Net Cash from Operating Activities		
Operating loss	\$ (1,155,764)	\$ (194,499)
Changes in assets and liabilities:		
Due from other governmental units	(238,708)	-
Accounts payable	101,176	8,544
Net cash used in operating activities	\$ (1,293,296)	\$ (185,955)

Noncash Investing, Capital, and Financing Activities - During the years ended September 30, 2017 and 2016, there were no noncash activities.

Karegnondi Water Authority

Notes to Financial Statements September 30, 2017 and 2016

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 its customers. The Genesee County Drain Commissioner has financial accountability for KWA. This is subject to change based upon redistribution of capacity units. KWA began full operations in November 2017.

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 - The proprietary fund includes an enterprise fund, which provides goods or services to users in exchange for charges or fees. The Authority only has one fund, the Water Fund, which provides water to customers through a pipeline constructed from Lake Huron. All activities necessary to provide such services are accounted for in this fund, including, but not limited to, administration, maintenance, billing, and collection.

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 revenue is not applicable to special purpose governments engaged only in business-type activities.

Karegnondi Water Authority

Notes to Financial Statements September 30, 2017 and 2016

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 in debt service reserve accounts. 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 current accrued interest due and principal due on the capital lease, 2014A Water Supply System Bonds, and the 2016 Water Supply System Bonds will be paid from these restricted assets and, therefore, has been reported as a noncurrent liability to the extent of restricted assets available. The construction accounts payable will be liquidated from unspent bond proceeds and have also been reported in this category to the extent of restricted assets available.

Capital Assets - Capital assets are defined by the Authority as assets with an initial individual cost of more than \$10,000 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 acquisition value at the date of donation. The water transmission line costs from Lake Huron are being reported as construction in progress until the asset is fully placed in service during fiscal year 2018, 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. Interest expense (net of interest income) of \$14,903,686 and \$13,349,049 was capitalized as part of the cost of assets under construction for the years ended September 30, 2017 and 2016, respectively.

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, 2017 and 2016

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 revenue and expenses from nonoperating items. Operating revenue 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 revenue of the Water Fund is charges to customers for sales and services. Operating expenses for the enterprise fund include the cost of sales and services and administrative expenses. All revenue and expenses not meeting this definition are reported as nonoperating revenue 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.

Reclassifications - Certain amounts presented in the prior year data have been reclassified in order to be consistent with the current year's presentation.

Note 2 - Deposits and Investments

Deposits and investments are reported in the financial statements as of September 30, 2017 and 2016 as follows:

	<u>2017</u>	<u>2016</u>
Cash and cash equivalents	\$ 5,877,667	\$ 7,159,901
Restricted assets	<u>39,968,773</u>	<u>45,429,465</u>
Total	<u>\$ 45,846,440</u>	<u>\$ 52,589,366</u>

Karegnondi Water Authority

Notes to Financial Statements September 30, 2017 and 2016

Note 2 - Deposits and Investments (Continued)

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

	Primary Government 2017	Primary Government 2016
Cash deposits with financial institutions	\$ 8,262,702	\$ 18,969,730
Investments - Certificates of deposit (with maturities in excess of 90 days)	11,406,457	5,563,744
Investments - Money markets	26,177,281	28,055,892
Total	<u>\$ 45,846,440</u>	<u>\$ 52,589,366</u>

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 matures 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 two 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. For the years ended September 30, 2017 and 2016, the Authority had \$7,234,078 and \$17,942,717, respectively, (checking and savings accounts) that were not fully insured or collateralized.

Karegnondi Water Authority

Notes to Financial Statements September 30, 2017 and 2016

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. During the year ended September 30, 2016, the Authority liquidated all repurchase agreement investments.

The Authority categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets, Level 2 inputs are significant other observable inputs, and Level 3 inputs are significant unobservable inputs. Investments that are measured at fair value using the net asset value per share (or its equivalent) as a practical expedient are not classified in the fair value hierarchy. As of September 30, 2017 and 2016, all cash and investments owned by the Authority are properly valued at cost; therefore, there is no fair value hierarchy applicable.

Note 3 - Restricted Assets

The restricted assets are restricted for the following purposes:

	<u>2017</u>	<u>2016</u>
Unspent bond proceeds and related interest	\$ 1,856,411	\$ 10,909,829
County construction deposits	528,624	900,000
General obligation bond restrictions:		
Debt reserve	26,177,281	33,619,636
Capacity/Debt service fee for debt service	<u>11,406,457</u>	<u>-</u>
Total restricted assets	<u>\$ 39,968,773</u>	<u>\$ 45,429,465</u>

The general obligation bond debt reserve is restricted for debt service per the bond agreement. The capacity/debt service fee is restricted per the bond agreement for current principal and interest payments on general obligation bonds and the capital lease.

Net position has been restricted at September 30, 2017 and 2016 for \$7,514,028 and \$950,515, respectively, related to the restricted assets held for debt service net of the related payable.

Karegnondi Water Authority

Notes to Financial Statements September 30, 2017 and 2016

Note 4 - Capital Assets

Capital asset activity of the Authority's business-type activities for the years ended September 30, 2017 and 2016 was as follows:

Business-type Activities	Balance October 1, 2016	Additions	Disposals	Balance September 30, 2017
Capital assets not being depreciated - Construction in progress	\$ 310,377,287	\$ 21,050,202	\$ -	\$ 331,427,489
	Balance October 1, 2015	Additions	Disposals	Balance September 1, 2016
Capital assets not being depreciated - Construction in progress	\$ 181,395,807	\$ 128,981,480	\$ -	\$ 310,377,287

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

	Spent to Date	Remaining Commitment
Water pipeline	\$ 257,489,982	\$ 3,920,204

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	Amount
Business-type Activities	
2014A Water Supply System Bond, used to construct water pipeline, bearing interest from 3 percent to 5.25 percent, maturing in 2043	\$ 220,500,000
2016 Water Supply System Bond, used to construct water pipeline, bearing interest on the first of each month at a variable annual rate of 3.15 percent plus 70 percent of the 30-day LIBOR, maturing in 2018	74,370,000
Total	\$ 294,870,000

Karegnondi Water Authority

Notes to Financial Statements September 30, 2017 and 2016

Note 5 - Long-term Debt (Continued)

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Business-type Activities - 2017					
Bonds	\$294,870,000	\$ -	\$ -	\$294,870,000	\$ 78,475,000
Plus deferred amounts - Issuance premiums	<u>10,633,990</u>	<u>-</u>	<u>393,852</u>	<u>10,240,138</u>	<u>-</u>
Total bonds payable	305,503,990	-	393,852	305,110,138	78,475,000
Capital lease (Note 6)	<u>35,000,000</u>	<u>-</u>	<u>-</u>	<u>35,000,000</u>	<u>865,000</u>
Total business-type activities - 2017	<u>\$340,503,990</u>	<u>\$ -</u>	<u>\$ 393,852</u>	<u>\$340,110,138</u>	<u>\$ 79,340,000</u>
Business-type Activities - 2016					
Bonds	\$220,500,000	\$ 74,370,000	\$ -	\$294,870,000	\$ -
Plus deferred amounts - Issuance premiums	<u>11,027,841</u>	<u>-</u>	<u>393,851</u>	<u>10,633,990</u>	<u>-</u>
Total bonds payable	231,527,841	74,370,000	393,851	305,503,990	-
Capital lease (Note 6)	<u>35,000,000</u>	<u>-</u>	<u>-</u>	<u>35,000,000</u>	<u>-</u>
Total business-type activities - 2016	<u>\$266,527,841</u>	<u>\$ 74,370,000</u>	<u>\$ 393,851</u>	<u>\$340,503,990</u>	<u>\$ -</u>

A total of \$12,054,522 of the \$79,340,000 due within one year is included in payable from restricted assets on the statement of net position.

Total interest expense for the years ended September 30, 2017 and 2016 was \$15,418,194, of which \$14,903,686 (interest expense net of interest income) was capitalized, and \$13,907,194, of which \$13,349,049 (interest expense net of interest income) was capitalized, respectively.

Management is currently in the process of refinancing the 2016 Water Supply System Bond that matures in 2018. See Note 9 for further information.

Karegnondi Water Authority

Notes to Financial Statements September 30, 2017 and 2016

Note 5 - Long-term Debt (Continued)

Annual debt service requirements to maturity for the above bonds and note obligations are as follows:

Years Ending September 30	Business-type Activities		
	Principal	Interest	Total
2018	\$ 78,475,000	\$ 14,476,840	\$ 92,951,840
2019	4,275,000	10,861,863	15,136,863
2020	4,475,000	10,669,612	15,144,612
2021	4,655,000	10,471,362	15,126,362
2022	4,870,000	10,263,238	15,133,238
2023-2027	28,035,000	47,439,563	75,474,563
2028-2032	35,960,000	39,271,875	75,231,875
2033-2037	46,235,000	28,759,669	74,994,669
2038-2042	59,560,000	15,071,162	74,631,162
2043-2044	28,330,000	1,433,750	29,763,750
Total	<u>\$ 294,870,000</u>	<u>\$ 188,718,934</u>	<u>\$ 483,588,934</u>

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:

Years Ending September 30	Amount
2018	\$ 2,509,887
2019	2,509,887
2020	2,507,587
2021	2,504,813
2022	2,499,938
2023-2027	12,488,056
2028-2032	12,441,513
2033-2037	12,378,191
2038-2042	12,513,288
Total minimum lease payments	62,353,160
Less amount representing interest	<u>(27,353,160)</u>
Present value	<u>\$ 35,000,000</u>

Karegnondi Water Authority

Notes to Financial Statements September 30, 2017 and 2016

Note 6 - Capital Lease (Continued)

Interest has been accruing on the capital lease since inception. As of September 30, 2017, \$692,578 is current accrued interest payable and \$5,258,648 is long-term accrued interest payable. The current interest payable is included in noncurrent liabilities - payable from restricted assets.

Note 7 - Capacity/Debt Service Fee

KWA entered into two separate water purchase contracts to supply untreated water, each with an effective date of October 1, 2013. A contract with the Genesee County Drain Commissioner provides the right to the delivery and use of up to 42 million gallons per day of untreated water. In July 2017, the System began providing untreated water to the Genesee County Drain Commissioner for testing purposes. A contract with the City of Flint, Michigan provides the right to the delivery and use of up to 18 million gallons per day of untreated water.

Under a long-term water supply contract entered into by the City of Flint, Michigan (Flint) and the Great Lakes Water Authority (GLWA) as of December 1, 2017 (the "GLWA Water Service Contract"), GLWA will supply Flint with treated water as its primary water source for an initial period of 30 years. Pursuant to the terms of the GLWA Water Service Contract, Flint has granted to GLWA certain rights of Flint under the Flint Water Purchase Contract to untreated water from the System. A KWA Financing Contract is included in the KWA Water Purchase Contracts and sets forth the manner in which the capital costs of the System facilities will be allocated. Under the KWA Financing Contract, the City of Flint, Michigan and the Genesee County Drain Commissioner are responsible for paying approximately 34 percent and 66 percent, respectively, of the debt service on the KWA System Bonds. (This allocation takes into account and credits the Genesee County Drain Commissioner for financing and being responsible for the payment of 100 percent of the costs of the Intake portion of the project.) These debt service payments by the City of Flint, Michigan and the Genesee County Drain Commissioner constitute the 2017 Capacity/Debt Service Fee collected in the amount of \$17,760,242 as of September 30, 2017.

Note 8 - Related Party Transactions

The 2014A and 2016 Water Supply System Bonds of Karegnondi Water Authority are guaranteed through 2043 by both Genesee County and the City of Flint, Michigan in the amounts of approximately 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 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 used to construct the water intake and related pumps for KWA. Once the bonds are redeemed, the title to the water intake and related pumps will be transferred to KWA.

Karegnondi Water Authority

Notes to Financial Statements September 30, 2017 and 2016

Note 9 - Subsequent Events

In late November, 2017, KWA and the County Agency began providing water to many of the Genesee County communities.