The Financial Implications of Debt Funding

A WATER RATIONING PROGRAM
The Balance Sheet (or Statement of Net Position)

- **ASSETS** – What does the District own?
  - Assets must be owned by the District
  - District must have control of the asset’s use

- **LIABILITIES** – What does the District owe?
  - Vendor payables
  - Wages and benefits owed
  - Includes debt principal and interest

- **NET POSITION** – What is left over?
  - Assets minus liabilities
  - Also called equity or net worth
  - A decrease in assets or an increase in liabilities lowers the District’s net position
The Income Statement (or Changes in Net Position)

- **OPERATING REVENUE**
  - Water sales and associated fees

- **OPERATING EXPENSES**
  - Cost of sales
  - G & A
  - Depreciation of capital assets over time

- **NON-OPERATING REVENUE (EXPENSE)**
  - Interest earned on invested cash
  - Interest expended on borrowed funds

- **CAPITAL CONTRIBUTIONS**
  - Grants
  - Capacity charges
  - Developer-donated system improvements
How Financial Statements Work Together

Assets increase as water sales are billed and collected

Each fiscal year a portion of capital assets are expensed as depreciation

Liabilities decrease as vendors and employees are paid

Net income for a fiscal year improves net position and the District’s reserves. A net loss would have an adverse effect
Debt Funding a Water Rationing Program

**Length of Term**
- Useful life of product purchased must match the term of the debt issuance

**Debt Strategy**
- Requires a mix of long-term and short-term borrowing
- Only a portion of Phase I can be funded through borrowing

**Borrowing Costs**
- Multiple borrowings will increase the cost of issuing debt
Financial Statement Impacts of Water Rationing Program

**Borrowing for Capital Asset Purchases**
- Bulk of expenditure appears on balance sheet as an asset
- Expensed over time as depreciation
- Smooths the impact on net income (loss)
- District net position remains relatively stable as the asset is offset by the debt liability

**Borrowing for Operating Expenditures**
- Expenditure appears on the income statement
- Entire expense recognized in a single fiscal year
- Significant effect on net income (loss)
- Net position declines because debt liability is not offset by an asset
Debt Service Coverage

• In lieu of collateral, the District has pledged water rates will be maintained at a level necessary to meet debt service coverage.

• Net revenues (operating revenue less operating expenses) must be at least 120% of the interest and principal payments due on debt each fiscal year.

• Conservation programs are excluded from operating expenses for purposes of calculating the debt coverage ratio.

• Without a corresponding increase in water revenue, debt coverage ratio decreases as debt increases.
Potential Effect on Water Rates

- Water rate revenue will need to be maintained to meet debt coverage requirements and keep reserve levels healthy.
- Successful rationing program will put upward pressure on rates.
- Switch from capital assets to operating cost will increase net income volatility and effect net position.
• How much can we borrow for a water rationing program and still have funding options available for supplemental supply?

• How can we structure the program and the financing to avoid rate spikes?

• How much of our operating expense budget can we commit to this program annually and still maintain healthy reserves?