

**ARENAS VALLEY WATER DEVELOPMENT  
FINANCIAL PLAN**

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Prepared by:

**Rural Community Assistance Corporation**

# Arenas Valley Water Development Association Financial Management Pilot Project

Arenas Valley is an unincorporated community located in Grant County, New Mexico, situated on both sides of US Highway 180, approximately 2.5 miles east of the Town of Silver City and 2 miles west of the Village of Santa Clara. The community consists of individual dwellings constructed on relatively large, undeveloped lots which are linked by a common water system.



The Arenas Valley Water Development Association was organized in 1979 as a non-profit corporation for the purpose of providing drinking water to the Arenas Valley community residents. The drinking water source for the Arenas Valley community members is purchased from the Town of Silver City on a contract basis, which is expiring during 2007 and it is currently under negotiations. Over the years, the membership for the Arenas Valley Water Development Association has grown at a rate of 12.5% per year reaching its connection capacity of 451 during 2006. The Association operates in a fiscal year structure which runs from January 1<sup>st</sup> through December 31<sup>st</sup> of each year.

## **The Financial Management Plan, Purpose and Elements**

The financial management plan identifies the annual cash requirements of the utility to conduct its normal day-to-day operations and it identifies its future operating and capital needs. It also attempts to determine whether the projected revenue under existing rates will satisfy those needs. The primary objective of this process is to ensure that the utility has the ability to obtain sufficient funds to develop, construct, operate, maintain, and manage its water system on a continuing basis, in full compliance with federal, state, and local requirements.

The basic financial plan for a volunteer board based utility includes:

- Revenue Sources-operating;
- Operation and Maintenance (O&M) expenses;
- Debt Service (principal and interest payments) on borrowed funds;
- Reserve requirements, and
- Long Term Planning.

The development of the Arenas Valley Water Development Association Financial Management Plan was accomplished utilizing the actual operating revenues and operating expenses from FY04- FY06.

## Revenue Sources

Utility systems operate on two types of revenue sources:

Operating revenue is the stable and reliable income from the operations of a utility system and includes:

- Income from water sales and service fees

Non-operating revenue includes:

- Interest on checking and reserve accounts
- Meter deposits
- Connection fees\*
- Late payments, penalties and reconnection fees\*

\*Connection fees and income from late payments, penalties and reconnection fees may also be considered operating revenue sources if they are stable and dependable revenue sources. For example, a water system with consistent growth that is expected to continue may consider connection fees as an operating revenue source.

For most water systems, income from the sales of water (water rates) and service fees are the primary sources of operating revenues.

### Arenas Valley Water Development Association Operating Revenues

The Association implemented a rate increase during May 2006. The current rate structure is reflected in Table 1.

**Table 1. Arenas Valley Water Development Association Current Rate Structure**

<b>Basic Charge</b> <i>This fee does not include water and it is charged whether water is used or not.</i>	\$25.00 + tax per meter connection*
First 3,000 gallons per month	\$2.59 per Thousand Gallons
Next 10,000 gallons per month	\$4.80 per Thousand Gallons
Next 52,000 gallons per month	\$5.43 per Thousand Gallons
Over 65,000 gallons per month	\$10.86 per Thousand Gallons
*Gross Receipt tax is added to each bill.	

## Operating Revenues

Table 2 displays the actual revenues generated during 2006.

**Table 2. 2006 Actual Revenue Budget  
Arenas Valley Water Development Association**

**2006 Actual Budget**

Line Item	Operating and Non-Operating Revenue:	2006 Actual Revenue
1	<b>Water Sales*</b>	<b>\$ 251,832.00</b>
2	Membership	\$ 41,100.00
3	Late Charges	\$ 4,430.00
4	Interest Income	\$ 9,083.00
5	Other fees	\$ 347.00
6	Charges for Services	\$ -
7	Assessments penalty	\$ -
8	Miscellaneous	\$ -
9	<b>Total Revenue:</b>	<b>\$306,792.00</b>

**\* Operating Revenues**

## Operating Expenses

Operating expenses are only one part of the major costs assumed by a utility in order to operate a self-sustaining enterprise; however, there are other cost categories that are considered when developing a financial plan.

Table 3 below, illustrates the actual operating expenses for 2006 and the cost category breakdown as reported in their un-audited financial statements.

**Table 3. 2006 Actual Expense Budget**

<b>Arenas Valley Water Development Association</b>		
<b>2006 Actual Budget</b>		
Line Item	Expense Category:	2006 Expense Budget
10	Cost of Goods Sold - Water	\$ 94,643.27
11	Cost of Goods Sold - PRV	\$ 84.30
12	Cost of Goods sold - Inventory	\$ 4,485.37
13	Water Loss Expense	\$ 32,597.77
14	<b>Total Water Purchase Expenses:</b>	<b>\$ 131,810.71</b>

Line Item	Operating Expenses:	2006 Expense Budget
15	Depreciation Exp: Water System*	\$ 35,610.72
16	Depreciation Exp: Office Equipment*	\$ 793.68
17	Depreciation Exp: Building8	\$ 4,545.84
18	Dues & Subscriptions	\$ 205.00
19	Insurance: Liability	\$ 755.00
20	Insurance: Surety Bond	\$ 1,343.82
21	Insurance: Workers Comp.	\$ 1,629.00
22	Licenses & Permits	\$ 205.00
23	Accounting Fees	\$ 2,475.00
24	Consulting Expense	\$ 24,340.00
25	Legal Fees	\$ 3,856.50
26	Association Vehicle Expenses	\$ 1,194.95
27	Tools	\$ 2,214.78
28	Telephone Expense	\$ 2,544.57
29	Office Supplies	\$ 2,656.26
30	Util. – Gas Propane	\$ 540.45
31	Util. – Electric	\$ 461.20
32	Utilities Expense	\$ -
33	Util. – Garbage	\$ 63.00
34	Postage & Delivery Expense	\$ 2,340.32
35	Property Taxes	\$ 382.00
36	Maintenance: Building	\$ 287.31
37	Maintenance: Computer	\$ 727.94
38	Maintenance: General	\$ 685.05
39	Maintenance: System Repair	\$ 17,630.49
40	Public Relations	\$ 279.32
41	Wages: Salaries	\$ 47,814.75
42	Payroll Taxes: FICA/E	\$ 3,063.73
43	Payroll Taxes Medicare/E	\$ 641.14
44	Payroll Taxes: Workers Comp/E	\$ 21.00
45	Payroll Taxes: SUTA	\$ 32.09
46	Payroll Taxes: FUTA	\$ -
47	Payroll Expense: BC/BS	\$ 1,420.43
48	Wages: Casual Labor	\$ -
49	Travel: Lodging & Meals	\$ 4,363.12
50	Training: Registration	\$ 881.97
51	Office Travel	\$ 1,674.41
52	Misc. Charges	\$ 26.91
53	Advertising	\$ 113.69
54	Purchase Disc – Expense Items	\$ -
55	Theft Loss	\$ -
56	<b>Total Expenses:</b>	<b>\$ 299,631.15</b>

*\* Not an actual expense – only transfer through*

## Reserves

Reserves are an accepted way to stabilize and support a utility financial management plan. Water utilities that have issued debt to pay for capital assets will often have required reserves that are specifically defined to meet the legal covenants of the debt. Normally, debt service reserve represents 10% of the annual loan payment and it is set aside into a dedicated account to be used only for its intended purpose, which is to be replenished every time it is used. In addition to debt reserve, utilities may also be required to establish other "targeted" reserves. Funds are set aside for a specific upcoming financial need or project or for an amount that can be used to provide rate stabilization in years when revenues are unusually low or expenditures are unusually high.

Many utilities, as well as financial rating agencies and the investment community as a whole, place special emphasis on reserve fund balances that are adequate to serve as a cushion or protection to the financial security for the utility under potentially adverse conditions. The basis for, or rationale related to the maintenance of adequate reserve balance levels is twofold. First, it helps to assure the utility that it will have adequate funds available to meet its financial obligations in times of varying needs. More important, it provides a framework around which financial decisions can be made to determine when reserve balances are inadequate or excessive and what specific actions need to be taken to remedy the situation.

Utility reserve balances can be thought of as similar to a savings account. Reserve balances are funds that are set aside for a specific cash flow requirement, financial need, project, task, or legal covenant. These balances are maintained in order to meet short-term cash flow requirements and, at the same time, minimize the risk associated with meeting financial obligations and continued operational needs under adverse conditions.

The most common reserve balances are usually established around the following four areas: operating, capital improvement a.k.a. depreciation, emergency, and debt. The Association does not have a reserve system in place. The Association has a substantial amount of cash in hand and/or invested into high yield accounts such as CDs, but it does not have a breakdown of the savings planning how and why the money should be spent or to plan for the future. RCAC strongly recommend considering setting up an emergency reserve account to help plan accordingly and react to any adverse situations.

### **1. Operating Reserve**

Operating reserves are typically established to provide the utility with the ability to withstand cash-flow fluctuations. There can be a significant length of time between when a system provides a service and when a customer may pay for that service. In addition to timing, the volume of cash flow can be affected by weather and seasonal demand patterns. A 45 day (approximately 6 weeks) operating reserve is a frequently used industry norm. Because of the potential delay in payment, many utilities attempt to keep an amount of cash equal to at least 45 days or one eighth of their annual cash O&M expenses in an operating reserve to mitigate potential cash flow problems. Based on the projected expense budget for 2007, RCAC recommends a total of \$33,201.69 as the set aside amount for this reserve. However, since the Association has cash in hand, this reserve account can either be fully funded during the 2007 fiscal year or the target can be met over a 3-yr. period. Obviously, fully funding this reserve from existing cash-on hand would reduce the need for additional increase to the rates.

**2. Emergency Reserve**

An emergency reserve is on-hand cash for unplanned major maintenance or equipment failure. Emergency reserves are often included with the operating reserve. How much should be set aside? Some specialists suggest setting aside enough cash to cover cost of replacement of the most “vulnerable component” (component most prone for failure) of the system. Replacement of key transmission lines would be considered the most vulnerable component for the Arenas Valley small water systems. Another approach is to review any emergencies that took place in the last 12 to 24 months and how much each cost to resolve. Another factor included is the age of the system and the physical status of the water system infrastructure. RCAC recommends determining a good emergency reserve target and setting aside funds to meet the target identified.

**3. Capital Improvement Reserve**

A capital reserve balance, or a repair and replacement reserve, is intended to be used to replace system assets that have become worn out or obsolete. For this reason, annual depreciation expense is frequently used as a metric to determine the minimum level of funding for this capital reserve. It is important to understand that depreciation expense is an accounting concept for estimating the decline in useful life of an asset and does not represent the current replacement cost of that asset. Therefore, an optimal balance may be an amount that is greater than annual depreciation expense to approximate replacement cost. Capital replacement reserves for equipment and main replacements or other normal annual capital



additions and replacements are typically estimated at the rate of 1% to 2% of total original cost asset value of the utility's property. In an effort to come up with the most accurate capital improvement reserve fund for the Arenas Valley water system, RCAC considered the assets owned by the Association and the 2007-2011 ICIP. According to the un-audited balance sheet from FY 06, the Association has a net worth in assets \$1,790,425. If the reserve is set at 1% of the annual value, the Association would have to set aside \$17,904.25 during FY 07. This figured would the have to be adjusted from year to year based on the asset value changes. On the other hand, the Capital Infrastructure Plan proposes water system improvements at an estimated value of \$150,000.00 to take place between 2007 and 2011. Considering both figures, the amount being proposed for the capital improvement reserve account for the 2007 fiscal year, the set aside recommended is estimated at \$47,904.25, and based on the financial information from 2004-2006, the assets have increased at a rate of 2% per year, that annual increase needs to be built in to the capital improvement when calculating the needed reserves for subsequent year.

Table 4 below, illustrates the proposed reserves for the Association. Once again, the reserve amounts being recommended are based on the financial data provided and the plans from the Association.

**Table 4 2007 Fiscal Year Proposed Reserves**

<b>Reserves</b>	
Capital Improvement Reserve	\$47,904.25
Emergency Reserve*	\$0.00
Operating Reserve	\$33,201.70
<b>Total reserves</b>	<b>\$81,105.95</b>

\* To be determined by the Arenas Valley Water Development Association board.

**Table 5. Reserve Summary Worksheet**

<b>DEBT SERVICE RESERVE</b>		
<b>Debt service reserve requirements</b>	<b>Remaining years to reach reserve target</b>	<b>Annual required set aside</b>
1.		\$
	<b>TOTAL</b>	\$
<b>CAPITAL IMPROVEMENT RESERVE</b>		
<b>Potential replacement components</b>		<b>Estimated cost of repair or replacement</b>
1. System Expansion		\$50,000.00
2. Purchase Truck and Backhoe		\$100,000.00
<b>TOTAL</b>		\$150,000.00
A. Estimated total target capital improvement reserve		\$ <u>179,042.50</u>
B. Existing capital improvement reserves		\$ <u>-0-</u>
C. Remaining cash needed to reach target		\$ <u>179,042.50</u>
D. To be collected in		<u>5</u> years.
E. Annual set aside target (= C ÷ D)		\$ <u>47,904.25</u>
<b>OPERATING RESERVE</b>		
Target operating reserve = $\frac{1}{8} \times$ Annual operating expenses (not including debt)		
\$265,613.56 x 1/8 = \$ <u>33,201.70</u> (Based on 2007 Projected Expense Budget)		
A. Existing operating reserves		\$ <u>-0-</u>
B. Remaining cash needed to reach target		\$ <u>33,201.70</u>
C. To be collected in		<u>3</u> year
D. Annual set aside target (= B ÷ C)		\$ <u>11,607.23 plus annual inflation and/or expansion</u>

## Proposed Expense Budget

The proposed operating expenses for FY07 include the proposed reserve set aside and an annual inflation rate. The inflation rate being proposed is 2.68%, following the Consumer Price Index (CPI) for the FY06-07 period. The CPI annual inflation average has been around 3% for the last 20 years.

**Table 6. 2007 Proposed Expense Budget with Inflation**

Operating Expenses:		2006 Actual Expenses	2.68% Inflation	2007 Projected Expense
10	Cost of Goods Sold - Water	\$ 94,643.27	\$ 2,536.44	\$ 97,179.71
11	Cost of Goods Sold - PRV	\$ 84.30	\$ 2.26	\$ 86.56
12	Cost of Goods sold - Inventory	\$ 4,485.37	\$ 120.21	\$ 4,605.58
13	Water Loss Expense	\$ 32,597.77	\$ 873.62	\$ 33,471.39
18	Dues & Subscriptions	\$ 205.00	\$ 5.49	\$ 210.49
19	Insurance: Liability	\$ 755.00	\$ 20.23	\$ 775.23
20	Insurance: Surety Bond	\$ 1,343.82	\$ 36.01	\$ 1,379.83
21	Insurance: Workers Comp.	\$ 1,629.00	\$ 43.66	\$ 1,672.66
22	Licenses & Permits	\$ 205.00	\$ 5.49	\$ 210.49
23	Accounting Fees	\$ 2,475.00	\$ 66.33	\$ 2,541.33
24	Consulting Expense	\$ 24,340.00	\$ 652.31	\$ 24,992.31
25	Legal Fees	\$ 3,856.50	\$ 103.35	\$ 3,959.85
26	Association Vehicle Expenses	\$ 1,194.95	\$ 32.02	\$ 1,226.97
27	Tools	\$ 2,214.78	\$ 59.36	\$ 2,274.14
28	Telephone Expense	\$ 2,544.57	\$ 68.19	\$ 2,612.76
29	Office Supplies	\$ 2,656.26	\$ 71.19	\$ 2,727.45
30	Util. - Gas Propane	\$ 540.45	\$ 14.48	\$ 554.93
31	Util. - Electric	\$ 461.20	\$ 12.36	\$ 473.56
32	Utilities Expense	\$ -	\$ -	\$ -
33	Util. - Garbage	\$ 63.00	\$ 1.69	\$ 64.69
34	Postage & Delivery Expense	\$ 2,340.32	\$ 62.72	\$ 2,403.04
35	Property Taxes	\$ 382.00	\$ 10.24	\$ 392.24
36	Maintenance: Building	\$ 287.31	\$ 7.70	\$ 295.01
37	Maintenance: Computer	\$ 727.94	\$ 19.51	\$ 747.45
38	Maintenance: General	\$ 685.05	\$ 18.36	\$ 703.41
39	Maintenance: System Repair	\$ 17,630.49	\$ 472.50	\$ 18,102.99
40	Public Relations	\$ 279.32	\$ 7.49	\$ 286.81
41	Wages: Salaries	\$ 47,814.75	\$ 1,281.44	\$ 49,096.19
42	Payroll Taxes: FICA/E	\$ 3,063.73	\$ 82.11	\$ 3,145.84
43	Payroll Taxes Medicare/E	\$ 641.14	\$ 17.18	\$ 658.32
44	Payroll Taxes: Workers Comp/E	\$ 21.00	\$ 0.56	\$ 21.56
45	Payroll Taxes: SUTA	\$ 32.09	\$ 0.86	\$ 32.95
46	Payroll Taxes: FUTA	\$ -	\$ -	\$ -
47	Payroll Expense: BC/BS	\$ 1,420.43	\$ 38.07	\$ 1,458.50
48	Wages: Casual Labor	\$ -	\$ -	\$ -
49	Travel: Lodging & Meals	\$ 4,363.12	\$ 116.93	\$ 4,480.05
50	Training: Registration	\$ 881.97	\$ 23.64	\$ 905.61

51	Office Travel	\$ 1,674.41	\$ 44.87	\$ 1,719.28
52	Misc. Charges	\$ 26.91	\$ 0.72	\$ 27.63
53	Advertising	\$ 113.69	\$ 3.05	\$ 116.74
54	Purchase Disc - Expense Items	\$ -	\$ -	\$ -
55	Theft Loss	\$ -	\$ -	\$ -
56	<b>Total Operating Expenses:</b>	<b>\$258,680.91*</b>	<b>\$ 6,932.65</b>	<b>\$ 265,613.56</b>
	<i>2006 Actual Operating Revenues</i>	\$251,832.00		\$251,832.00
57	<b>Net profit/loss</b>	<b>\$ (6,848.91)</b>		<b>(\$13,781.56)</b>

*\* The total operating expenses used for this calculation do not account for the depreciation costs since it is not an actual expense.*

## Reviewing the Rates to Meet Operating Expenses

As shown on table 6 above, the operating expenses exceeded the operating revenues generated during FY06. This shows that the Association has historically relied on non-operating revenues to cover a portion of the expenses incurred by the Association. Table 7 below outlines the revenue generated from the customer monthly fees and the revenues generated from the sales of water.

**Table 7. Operating Revenues under Current Rates**

<b>The revenue generated from the monthly minimum fee cover 42% of the fixed expenses</b>	\$ 135,300.00
<b>Variable Expenses are covered by the /1,000 gallon fee</b>	\$ 116,532.00
<b>Total Operating Revenue:</b>	\$ 251,832.00

In order to generate sufficient revenue to operate from operating revenues only, RCAC proposes for the rates to be adjusted accordingly. Please review tables 8, 9 and 10 for details.

**Table 8. Proposed Rate Adjustment to Meet 2007 Projected Expenses**

<b>2007 Projected Operating Expenses</b>	<b>\$265,613.56</b>
<b>Recommended service fee to cover 57% of the fixed expenses</b>	\$148,477.98
<b>Proposed Monthly Minimum per customer</b>	\$27.50 per month or \$329.95 per year
<b>Variable Expenses are covered by the /1,000 fee</b>	\$117,135.58
<b>Average cost per 1,000 gallons based on 2006 water sales of 30,154,680 gallons.</b>	\$3.88 per 1,000 gal.

**Table 9 Average Residential Proposed Rates**

<b>Minimum Bill</b>										
	\$	27.50	for 0 gallons							
Tier 1	0-3,000	gallons	for	\$	2.95	per		1,000	gallons	
Tier 2	3,001-6,000	gallons	for	\$	3.84	per		1,000	gallons	
Tier 3	6,001-10,000	gallons	for	\$	4.99	per		1,000	gallons	
379	uses @	0	gallons @	\$27.50	per users=		\$10,420.95	Monthly		
<b>Annual Revenue Generated from Residential Monthly Minimum Fee:</b>							<b>\$125,051.45</b>	<b>Annually</b>		
<b>Residential Use and Income Estimate:</b>	64	users @	0	gallons @	\$27.50	per customer=	\$1,759.74	Monthly		
	51	users @	0-1,000	gallons @	\$30.45	per customer=	\$1,552.74	Monthly		
	50	users @	1,001-2,000	gallons @	\$33.40	per customer=	\$1,669.80	Monthly		
	51	users @	2,001-3,000	gallons @	\$36.35	per customer=	\$1,853.64	Monthly		
	47	users @	3,001-4,000	gallons @	\$ 40.18	per customer=	\$1,888.50	Monthly		
	47	users @	4,001-5,000	gallons @	\$ 44.02	per customer=	\$2,068.75	Monthly		
	47	users @	5,001-6,000	gallons @	\$ 49.00	per customer=	\$2,303.07	Monthly		
	62	users @	6,001-10,000	gallons @	\$68.94	per customer=	\$4,274.49	Monthly		
<b>Total Residential Connections</b>	<b>419</b>									
<b>Annual Projected Revenue to be Generated from Residential Water Sales (not including service fee):</b>							<b>\$70,199.26</b>	<b>Annually</b>		

**Table 10. Commercial Connection and High End User Proposed Rate**

<b>Minimum Bill</b>	<b>\$ 35.74</b>	<b>Plus the average customer rate up to 10,000 gal.</b>					
10001-20,000		gallons	for	\$ 7.48	per	1,000	gallons
20,001-30,000		gallons	for	\$9.72	per	1,000	gallons
30,001-40,000		gallons	for	\$12.64	per	1,000	gallons
40,001-50,000		gallons	for	\$16.43	per	1,000	gallons
All Over 50,001		gallons	for	\$21.36	per	1,000	gallons
72	uses @	0	gallons @	\$ 35.74	per users=	<u>\$2,573.62</u>	Monthly
<b>Annual Revenue Generated from High End Users Monthly</b>							
<b>Minimum Fee:</b>						<b><u>\$30,883.42</u></b>	<b>Annually</b>
<b>Commercial use and Income Estimate</b>							
	32	users @	10,001-20000	gallons @	\$142.08	per customer=	\$4,546.54
	0	users @	20,001-30,000	gallons @	\$151.80	per customer=	\$0.00
	0	users @	30,001-40,000	gallons @	\$164.44	per customer=	\$0.00
	0	users @	40,001-50,000	gallons @	\$180.87	per customer=	\$0.00
	0	users @	50,001 PLUS	gallons @	\$202.23	per customer=	<u>\$0.00</u>
<b>Total number of Connections</b>	<b>32</b>						
<b>Annual Projected Revenue to be Generated from High End Users <span style="color: blue;">Water Sales</span></b>							
<b>(not including service fees):</b>						<b><u>\$ 40,832.51</u></b>	<b>Annually</b>

## **6 - Year Financial Plan**

A financial plan forecasting 6-years for the Association water utility was developed using the above listed information. The plan incorporates the revenue and cost data described earlier in the report. The plan begins with the FY06 actual budget and forecasts from FY07 through FY11.

The 6-year financial plan calculates the revenue increases necessary to provide positive revenue. In other words, how much revenue is required to operate a healthy and self-sustaining enterprise? Analysis of this scenario determined that in order to adequately fund all major cost categories the rates must be increased to generate an additional 6% in revenues. Additionally, and in order for the Association utility to operate as a self-sustaining enterprise, an annual rate adjustment to cover inflation cost between 2.5 and 3% must be implemented during subsequent years.

It is strongly recommended that after a 12 month period of the new rate implementation, a thorough assessment of the revenues vs. expenses and reserves be conducted. During the assessment, the Association might determine that the recommended annual rate adjustments are not sufficient as proposed and that additional adjustments are necessary. Additionally, RCAC recommends that the Association's decision making body reviews the budget projection and modifies it accordingly if any of the information used to calculate this analysis changes and/or any of the operating conditions of the utility experience a significant increase to its expense budget. It is recommended that every utility system reviews its rates once a year or more often if needed.

**Table 11. 6-yr. Budget Projection**

Line		FY 06-07 Proposed Year Budget	FY 07-08 Projected Annual Budget	FY 08	FY 09	FY 10	FY 11
	<b>REVENUE</b>						
	<u>Operating Revenues</u>						
1a	Service Revenue -Water	\$ 251,832.00	\$ 251,832.00	\$266,942	\$274,950	\$281,824	\$290,279
1b	Proposed Rate Increase/Rate Adjustment	0.00%	6.00%	3.00%	2.50%	3.00%	3.00%
1c	Additional Revenue from Increase/Adjustment	\$ -	\$ 15,109.92	\$ 8,008.26	\$ 6,873.75	\$ 8,454.72	\$ 8,708.36
1d	Revenue from Service Fees	\$ 251,832.00	\$ 266,941.92	\$ 274,950.18	\$ 281,823.93	\$ 290,278.65	\$ 298,987.01
2	<b>Total Operating Revenues</b>	\$ 251,832.00	\$ 266,941.92	\$ 274,950.18	\$ 281,823.93	\$ 290,278.65	\$ 298,987.01
8	<b>Total Revenue</b>	\$ 251,832.00	\$ 266,941.92	\$ 274,950.18	\$ 281,823.93	\$ 290,278.65	\$ 298,987.01
9	<b>Total O&amp;M Expenses</b>	\$ 258,680.91	\$ 265,613.56	\$ 273,581.97	\$ 281,789.43	\$ 290,243.11	\$ 298,950.40
10	<b>Subtotal- Net Operating Income</b>	(\$6,848.91)	\$ 1,328.36	\$ 1,368.21	\$ 34.51	\$ 35.54	\$ 36.61
	<b>Debt Service</b>	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
15	<b>NET INCOME (LOSS) FROM OPERATIONS</b>	(\$6,848.91)	\$ 1,328.36	\$ 1,368.21	\$ 34.51	\$ 35.54	\$ 36.61
16	<b>Plus: Beginning Cash Balance</b>	\$ -	\$ -	\$ 1,328.36	\$ 2,696.57	\$ 2,731.08	\$ 2,766.62
17	<b>Ending Cash Balance Before Reserves</b>	\$ -	\$ 1,328.36	\$ 2,696.57	\$ 2,731.08	\$ 2,766.62	\$ 2,803.23
	<b>RESERVES</b>						
18	Debt Service Reserve	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
19	Short-Lived Assets	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
20	Capital Improvement Reserve	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
21	Emergency Reserve	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
22	Operating Reserve	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
23	<b>Total Reserves</b>	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
24	<b>ENDING CASH BALANCE AFTER RESERVES</b>	(\$6,848.91)	1,328.36	2,696.57	2,731.08	2,766.62	2,803.23



## Findings & Recommendations

1. The financial plan only takes into account the operating revenues when making the calculations and it has concluded that the current water rates are inadequate to generate the needed operating revenues to cover the operating expenses. The financial information provided outlines where the Association has historically relied on non-operating revenues to cover some of the operating expenses over the years. In order for the Association to operate as a self-sustaining enterprise and achieve a sound operating financial footing, it is recommended that the Association relies only on the operating revenues it can generate from the monthly minimum and the commodity rates. In order to do that, the analysis proposes an increase to the monthly minimum from \$25.00 to \$27.50 and it further proposes to narrow the water usage ranges to help promote water conservation and guarantee sufficient revenues to cover operating expenses.

Additionally, and according to the information gathered, during 2006, the Association was able to collect \$135,300.00 from 451 customers. It is necessary to consider that not all 451 connections were a source of revenue during the entire 12 months cycle; however, the amount estimated determines that the Association was only able to generate sufficient revenue to cover the purchase of water from the Town of Silver City which was reported at \$131,810.70 for 2006. This means that the other fixed expenses such as payroll, insurance, taxes and other fixed costs were covered by the revenues generated from the commodity rate and the non-operating revenues.

2. The Association's current water rates are considerate "moderate" in relation to the other water systems in the area; however, in order to maintain a good financial structure, the rates must be reviewed at least once every year to ensure adequate coverage for the operating expenses. This water utility is one of the most financially stable in the southwest region, and is making an effort to continue operating in that mode. RCAC proposes the recommended reserves to be fully funded from the cash on-hand that the Association has currently invested in high yielding savings and CD accounts. The physical separation of reserve accounts does not mean that the funds cannot be invested to make them grow, what this means is that there will be designated accounts and sources of funds that will be used for their intended purpose only. In other words, if the funds

were set aside to meet the debt service in the event the Association is not able to make its payments, then the reserve funds would be used for such purposes. Additionally, RCAC proposed that two reserve accounts be set up, which are the operating reserve and the capital improvement reserve accounts. It is strongly recommended that the Association board considers setting up an emergency reserve account. This will help the board address any unplanned events without creating the need to draw out funds from other sources.

3. The 6-year financial plan performed reflects the need for an annual rate adjustment, and it recommends an annual review of the rates prior to the development of the following year's budget to better forecast the necessary revenue to cover all the major cost categories. As a norm, it is not uncommon to underestimate expenses and overestimate revenues. Adequate review and implementation of the rate structure increases the potential to adequately cover the operating expenses of the utility which should keep the Association's board from having to implement rate increases.
4. The Association has met its connection capacity under the current contract. Depending on negotiations with the Town of Silver City and the potential to increase connections, the main source of non-operating revenues being the membership/new connections might be significantly influenced during 2007. This situation might create the need for additional increases to the rates. Depending on the terms of the new contract and the ability to increase the capacity, RCAC recommends the set up of a water connection plan which can be directly linked to the financial plan of the Association. This will assist the Association to adequately project their financial operations!

## Summary

In conclusion, a rate increase should be implemented which should generate sufficient revenues to adequately cover ALL major operating costs to help guarantee safe and reliable drinking water to the Arenas Valley residents. If the financial plan is followed as proposed, the Association should be able to maintain its self-sustaining enterprise standard under which it has operated for many years.

The Association board should review this financial plan and contact RCAC if any of the information utilized for any of the calculations is either incorrect or has significantly changed since it was provided to RCAC. RCAC can be reached at (505) 382-6992. We thank you for the opportunity to worked with the Association and look forward to provide additional technical assistance in the very near future.

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