

**ILFELD MUTUAL DOMESTIC WATER
CONSUMERS ASSOCIATION**

FINANCIAL PLAN

April 30, 2007

Prepared by:

Rural Community Assistance Corporation

Ifeld Mutual Domestic Water Consumers Association Financial Management Pilot Project

Ifeld is an unincorporated community located in San Miguel County, New Mexico, situated along I-25, between Santa Fe and Las Vegas, New Mexico. The community consists of individual dwellings constructed on relatively large, undeveloped lots which are linked by a common water system the Ifeld Mutual Domestic Water Consumers Association (MDWCA) (“Association”). The drinking water source for the Association members is two wells.



Ifeld, NM

The Association has about 100 memberships but only about 80 members are active users every month. The community has experienced an increase in population in the last ten years. Due to lack of water rights and system capacity, the water Association has a cap on new memberships. The Association keeps a waiting list of interested local families who already have a dwelling on the property and want connection. They get priority

when an existing membership is relinquished or cancelled.

The Association operates in a fiscal year structure which runs from January 1st through December 31st of each year.

The Financial Management Plan, Purpose and Elements

The financial management plan reflects on the annual cash requirements of the utility to conduct its normal day-to-day operations and to identify 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 and non operating;
- Operation and Maintenance (O&M) expenses;
- Debt Service (principal and interest payments) on borrowed funds;
- Reserve requirements; and
- Long Term Planning.

The data used in developing the Ilfeld MDWCA Financial Management Plan was from the actual operating revenues and 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 fees
- Late payments, penalties and reconnection fees*

Non-operating revenue includes:

- Interest on checking and reserve accounts
- Membership and connection fees*

*Income from these fees are deposited into reserve accounts.

Operating Revenues

The Association Board of Directors with support from the membership implemented a new rate structure effective January 2006. This rate structure is aimed at meeting four goals set by membership:

- Providing adequate water service to the members;
- Meeting water rights obligations;
- Practicing water conservation; and
- Meeting the system's operating expenses and reserve funds.

To meet these goals, the board decided to use a "bracket rate structure" in which the monthly rates are dramatically lower for people who use less water. Also, the Association does not round up to the nearest 1,000 gallons. Customers are billed for the actual number of gallons used that month. All members whether they use the water or not pay the base rate monthly.

Table 1 shows the bracket rate structure. All members pay the same base rate of \$30 per month to support the fixed expenditures. The amount the customer pays per gallon is determined by the bracket they fall within. For example, a household that uses between 10,001 to 15,000 gallons will pay \$15 per 1,000 gallons, plus the base rate. Customers using over 10,001 gallons per month also pay a surcharge of between \$25 and \$75 per month. Customers can reduce the amount they pay per gallon by cutting the usage so that it falls within a lower bracket. Table 2 shows examples of monthly water bills.

Table 1. Ifield MDWCA Rate Structure.

	Base Rate	\$30.00	Per month	
	Usage:			
Bracket	Bracket per Usage	Cost per 1,000 gallons	Cost per each gallon used	Surcharge
1	Each gallon when usage falls between 1- 2,000	\$ 3.00	\$ 0.0030	
2	Each gallon when usage falls between 2,001- 4,000	\$ 4.00	\$ 0.0040	
3	Each gallon when usage falls between 4,001- 6,000	\$ 5.00	\$ 0.0050	
4	Each gallon when usage falls between 6,001- 8,000	\$ 8.00	\$ 0.0080	
5	Each gallon when usage falls between 8,001 to 10,000	\$ 10.00	\$ 0.0100	
6	Each gallon when usage falls between 10,001 to 15,000	\$ 15.00	\$ 0.0150	\$25.00
7	Each gallon when usage falls between 15,001 to 20,000	\$ 20.00	\$ 0.0200	\$50.00
8	Each gallon when usage falls between 20,001 and above	\$ 50.00	\$ 0.0500	\$75.00

Table 2. Ilfeld MDWCA Sample Monthly Water Bills

Usage Bracket	Example	Usage Charge	Total Bill
1,000 – 2,000 gallons (\$0.003 per gallon)	980 gallons	$.003 \times 980 = \$2.94$	Base Rate: \$30.00 Usage: \$2.94 Total: \$32.94 (plus tax)
2,001 – 4,000 gallons (\$0.004 per gallon)	3,251 gallons	$.004 \times 3251 = \$13.00$	Base Rate: \$30.00 Usage: \$13.00 Total: \$43.00 (plus tax)
4,001 – 6,000 gallons (\$0.005 per gallon)	5,723 gallons	$.005 \times 5,723 = \$28.62$	Base Rate: \$30.00 Usage: \$28.62 Total: \$58.62 (plus tax)
6,001 – 8,000 gallons (\$0.007 per gallon)	6,306 gallons	$.007 \times 6,306 = \$44.12$	Base Rate: \$30.00 Usage: \$44.12 Total: \$74.12 (plus tax)
8,001 – 10,000 gallons (\$0.01 per gallon)	9,500 gallons	$.01 \times 9,500 = \$95.00$	Base Rate: \$30.00 Usage: \$95.00 Total: \$125.00 (plus tax)
10,001 – 15,000 gallons (\$0.015 per gallon) plus \$25 surcharge	12,750 gallons	$.015 \times 12,750 = \$191.25$	Base Rate: \$30.00 Usage: \$191.25 Surcharge: \$25.00 Total: \$246.25 (plus tax)
15,001 – 20,000 gallons (\$0.02 per gallon) plus \$50 surcharge	17,020 gallons	$.02 \times 17,020 = \$340.40$	Base Rate: \$30.00 Usage: \$340.40 Surcharge: \$50.00 Total: \$420.40 (plus tax)

20,001 gallons or more (\$0.05 per gallon) plus \$75 surcharge	22,500 gallons	.05 x 22,500 = \$1,125.00	Base Rate: \$30.00 Usage: \$1,125.00 Surcharge: \$75.00 Total: \$1,230.00 (plus tax)
---	----------------	---------------------------	--

Operating Revenues

Table 3 displays the actual revenues generated during 2006.

Table 3. Ilfeld MDWCA 2006 Revenue Actual

IIfeld MDWCA

2006 Actual Revenue

Item	OPERATING REVENUE:	2006 Actual
1	Water Sales	\$61,540.58
2	Membership Fees	\$8,000.00
3	Membership Transfer Fee	\$500.00
4	Late charges and penalties	\$300.00
5	Other	\$515.23
6	Total Operating Revenue	\$70,855.81

Operating Expenses

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

Table 4. Ilfeld MDWCA Actual Operating Expenses for 2006

7	OPERATING EXPENSES:	
8	Bank Service Charges and Checks	\$15.00
9	Bookkeeping Fees	\$7,640.48
10	Legal Fees	\$783.82
11	Dues And Subscriptions	\$190.00
12	Liability Insurance	
13	Loan/Rip 94-02r	\$14,223.52
14	Loan/Wsc 85-25	\$378.92

15	Office Supplies	\$177.67
16	P.O. Box Rental	\$80.00
17	Postage	\$468.00
18	Printing And Reproduction	\$446.73
19	Contract Certified Operator Fees	\$9,214.77
20	Water Sampling	\$318.94
21	Repairs	\$689.32
22	Preventive Maintenance	\$0
23	Supplies And Materials	\$0
24	Storage Unit	\$455.00
25	Meeting Space Rental	\$300.00
26	Corporate Filing Fee	\$10.00
27	Travel/Mileage	\$50.59
28	Utilities: Telephone	\$410.89
29	Utilities: Electric	\$2,177.42
30	Software Related and Software Support	\$1,433.38
31	*Water Conservation Fee & Gross Receipt Taxes	\$2,839.12
32	Miscellaneous	\$423.83
33	Total Operating Expenses	\$42,727.40

*Collected and paid to Tax and Revenue

Reserves

Reserve funds stabilize and support the utility financial management. The reserve accounts can be thought of as similar to a savings account except that they are targeted for specific purposes, such as to complete specific improvements or additions to the infrastructure, to pay for an audit, replace meters, emergencies, etc.

Water utilities that have obtained loans to pay for capital assets may be required by the funder to establish a debt service reserve account. Normally, debt service reserves are set at 10% of the annual loan payment. This must be a separate account to be used only for its intended purpose (to pay the loan in times of shortfalls) and must be replenished every time it is used. In addition to debt reserves, utilities may also be required to establish other "targeted" reserves. The four most common reserve funds are operating, capital improvement a.k.a. depreciation, emergency, and debt. Utilities

must name their reserve funds and create policies for maintaining and using these funds.

Ifeld does not have a written-policy driven reserve system in place. The Association has cash in hand on a savings account, but it does not have a policy stating how and why the money should be spent. RCAC recommends the following reserve accounts.

1. Operating Reserve

Operating reserves are established to help with cash-flow fluctuations. There is a length of time between when a system provides a service and when a customer pays for that service. In addition to timing, the volume of cash flow can be affected by weather and seasonal demand patterns. The industry norm is to keep an amount of cash equal to at least 45 days or one eighth of the annual operating expenses to mitigate potential cash flow problems.

Ifeld annual Operating Expense Budget is set at \$57,786. Using the industry norm, the Association needs to set \$7,223.00 as the set-aside amount for the Operating Reserve. Since the Association has cash in hand, this reserve account can be fully funded during the 2007 fiscal year. This approach will help reduce the need for rate increases.

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 the cost of replacement of the most “vulnerable component” (component most prone for failure) of your system.

Ifeld’s most vulnerable component could be a pump or pump house related. RCAC recommends that the board discuss the amount of the reserve with the system certified operator. Since the Association has cash in hand, this reserve account can be fully funded during the 2007 fiscal year. This approach will help reduce the need for a rate increase.

3. Capital Improvement Reserve

A capital reserve balance, or a renewal 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.

Some utilities that have large amount of debt from completed capital improvements are not able to fully fund capital reserve accounts. In this case, the industry norm is to consider the annual renewal and replacement expenditures by the system plus the current principal amount on loans as the system's contribution to capital expenditures.

Another industry norm is to set the Capital Improvement Reserve Accounts at 1% to 2% of the utility's assets.

In an effort to make a recommendation for a capital improvement reserve fund to the Ilfeld MDWCA board, RCAC looked at the two different ways to set a capital improvements reserve. One way is to look at the Association's expenditures for renewal and replacement and for loan payments. Ilfeld's 2007 budget shows \$2,000 budgeted for renewal and replacement which they call "preventive maintenance" Ilfeld budgeted \$17,000 for loan payments (note that the loan payment includes both the interest and principal) for a total annual amount of \$19,000 to be spent in capital improvements related expenditures.

The second way is to set the capital improvements reserve at 1% or 2% of the system assets. The Association does not have a balance sheet giving us the net worth of the system. If the system, for example, is worth one million dollars, this reserve will be set as follows:

1% of system assets valued at \$1,000,000.00	\$10,000.00 in reserve
2 % of system assets valued at \$1,000,000.00	\$20,000.00 in reserve

This figure would the have to be adjusted from year to year based on 2% of system assets and how the asset value changes. The final decision on capital improvements reserves is up to the board. They are doing well completing annual system renewal and replacements. In order to continue to build a reserve over time they may want to consider to:

- continue to allocate and spend funds in renewal and replacements, increasing the amount every year as the system ages;
- continue to make the loan payment; and
- allocate and set a capital improvements reserve fund in order to gather enough money over a period of over 10 years to make a major improvement such as fully funding the storage tank replacement.

RCAC Recommendations:

The board is taking steps to build contingency funds. The 2007 Operating Budget shows that the Association proposes to set aside \$3,000 for emergency reserve funds. To continue to build the financial capacity of the Association, RCAC recommends:

1. Utilizing existing funds in the savings account to set and fully fund at least two of the recommended reserve accounts:
 Operating Reserve funded at \$7,300.00
 Emergency Reserve funded at \$10,000.00
2. Even if not required by the funder, set a debt reserve fund in the annual amount of the loan payments. Fund the reserve account over a period of 4 to 5 years.
3. Estimate the value of system assets and complete a Balance Sheet. With this information discuss with the certified operator, ways to set an annual Capital Improvements Reserve.
4. Create a policy naming the reserve accounts, setting the amount, stating the purpose, and the ways to access the accounts.
5. Set reserve accounts in interest bearing accounts.

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 at 3%. According to the Consumer Price Index, the annual inflation average has been around 3% over the last 20 years.

Table 5. Ifield MDWCA 2007 Proposed Expense Budget w/ Inflation

OPERATING EXPENSES:		ACTUAL 2006	3% Inflation	Projected Expenses
	Bank Service Charges and Checks	\$15.00	\$15.45	\$125.00
	Bookkeeping Fees	\$7,640.48	\$7,869.69	\$7,655.00
	Legal Fees	\$783.82	\$807.33	\$4,000.00
	Dues And Subscriptions	\$190.00	\$195.70	\$200.00
	Liability Insurance			\$3,000.00
	Loan/Rip 94-02r	\$14,223.52		\$12,563.00
	Loan/Wsc 85-25	\$378.92		\$4,465.00
	Office Supplies	\$177.67	\$183.00	\$400.00
	P.O. Box Rental	\$80.00	\$82.40	\$80.00
	Postage	\$468.00	\$482.04	\$468.00
	Printing And Reproduction	\$446.73	\$460.13	\$500.00
	Contract Certified Operator Fees	\$9,214.77	\$9,491.21	\$9,600.00
	Water Sampling	\$318.94	\$328.51	\$600.00
	Repairs	\$689.32	\$710.00	\$3,000.00
	Preventive Maintenance			\$2,000.00
	Supplies And Materials			\$3,000.00
	Storage Unit	\$455.00	\$468.65	\$420.00
	Meeting Space Rental	\$300.00	\$309.00	\$300.00
	Corporate Filing Fee	\$10.00		\$10.00
	Travel/Mileage	\$50.59	\$52.11	\$1,000.00
	Utilities: Telephone	\$410.89	\$423.22	\$500.00
	Utilities: Electric	\$2,177.42	\$2,242.74	\$2,300.00
	Software Related and Software Support	\$1,433.38	\$1,476.38	\$1,600.00
	*Water Conservation Fee & Gross Receipt Taxes	\$2,839.12		\$0
	Miscellaneous	\$423.83	\$436.54	
	Total Operating Expenses	\$42,727.40		\$57,786.00

Table 5. Continues...	Actual	Proposed
RESERVE FUNDS		
Emergency Reserve Funds	\$10,000.00	\$3,000.00
Capital Improvements Reserve Funds	\$ 2,000.00	
Operating Reserve Funds	\$ 8,000.00	
Total Reserve Funds	\$20,000.00	\$3,000.00
Total Expenses (Operating & Reserve Funds)	\$62,727.40	\$60,786.00

*The taxes are collected from the customer and paid to the state. They are not an additional expense to the Association.

Notes about the Expense Budget:

The board looked at the budget item by item and decided to increase some items more than the 3% inflation index. This determination was based on planned activities by the association and or knowledge of the up coming expense. For example the board plans to purchase insurance (\$3,000) in FY07.

Reviewing the Rates to determine if they meet the Operating Expenses

The operating revenues generated during FY06 were sufficient to cover all operating expenses. Because of new membership fees the Association exceeded the expected revenues and was able to fund reserve accounts as shown in Table 5 above.

Table 6. Ifeld MDWCA Calculating the Rates

DATA

Members	Active	Not active	Total
Total Membership	80	19	99

FY07 Budget	Annual Total	Fixed - 60%	Variable 40%
Total Expenses	\$60,786.00	\$35,255.88	\$25,530.12

Annual Average	Water Usage	4,400,000 gallons	
Average monthly	household usage	4,553 gallons	

SETTING THE
RATES:

FLAT RATE (not recommended when the system has meter)	Budget divided by total members divided by 12 months	\$60,786/99/12	\$51.17
BASE RATE (the minimum charge to recover a % of the total expenditures)	Fixed expenses divided by all members divided by 12 months	\$35,255.88/99/12	\$29.68
USAGAGE CHARGE (the charge per gallon used to pay for the balance of the expenditures not recovered through the base rate)	Variable Expenses divided by average annual water used	\$25,530.12/4,400,000	\$0.0058 for each gallon
USAGAGE CHARGE per 1,000 gallons	Usage charge per gallons multiplied by 1,000	\$.0050*1,000	\$5.80

RATE STRUCTURE

Brackets reflect water conservation goals

Base Rate	\$30.00	\$30.00	
1- 2,000	\$3.00	\$0.003	per gallon
2,001- 4,000	\$4.00	\$0.004	per gallon
4,001- 6,000	\$5.00	\$0.005	per gallon
6,001- 8,000	\$8.00	\$0.008	per gallon
8,001 to 10,000	\$10.00	\$0.010	per gallon
10,001 to 15,000	\$15.00	\$0.015	per gallon
15,001 to 20,000	\$20.00	\$0.020	per gallon

Notes about the Rate Structure:

The rate structure as mentioned above is a bracket system. The customer is encouraged to conserve water and keep his/her usage under the 4,001 to 6,000 gallons bracket. The rates for water usage between 4,001 and 10,000 reflect the cost of the water service. Water usage above 10,001 is being discouraged through higher rates and a surcharge.

Table 7 shows the estimated revenue to be recovered through the rate structure.

Table 7. Ilfeld MDWCA Estimating the Revenue to Expenses

Estimating Revenue	Estimated gallons per user	Rate per gallon	Average users in this bracket	Estimated Revenue	Estimated Water Usage
<i>Base Rate</i>		\$30.00	99	\$35,640.00	
1- 2,000	1,500	\$0.0030	10	\$540.00	180,000
2,001- 4,000	2,500	\$0.0040	19	\$2,280.00	570,000
4,001- 6,000	4,500	\$0.0050	43	\$11,610.00	2,322,000
6,001- 8,000	6,500	\$0.0080	14	\$8,736.00	1,092,000
8,001 to 10,000	8,500	\$0.0100	2	\$2,040.00	204,000
10,001 to 15,000		\$0.0150		\$0.00	0
15,001 to 20,000		\$0.0200		\$0.00	0
Totals			88	\$60,846.00	4,368,000

Conclusions about the Rate Structure Meeting Expenses:

The Association needs \$60,786.00 to meet the FY2007 and is using an average 4,400,000 gallons of water annually. The estimated numbers above based on last year's patterns show that if these patterns remain the same, the rate structure will meet the budget for FY2007. To analyze further years, we next completed a Five Year Financial Plan. This will help the board as they work with very challenging decisions.

The 6- Year Budget Projection

The six year budget projection helps a water system determine when it is necessary to make adjustments to their rates. The 6-yr. budget projection incorporates the revenue and cost data described earlier in the report. The plan begins with the FY06 actual financial data 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 community business, the water utility. The five year financial plan shows that in order to adequately fund all expenses and recommended reserve accounts, the board needs to implement a 2% rate increase beginning in FY09 and through FY11.

Recommendations from the six year budget projection:

The Association needs to implement a 1% rate increase in order to meet the FY2007 as approved by the board. From FY08 to FY10 we recommend a 2% rate increase a 3% increase in FY11. This will help establish a debt reserve fund in the amount of \$14,000 and a capital improvements reserve in the amount of \$2,000 per year.

Conclusion about the Six Year Budget Projection:

RCAC strongly recommends that after a 12 month period of any new rate implementation, the board conducts a thorough assessment of the revenues vs. expenses and reserves. During the assessment, the Association might determine that the recommended annual rate adjustments are not sufficient as proposed and that additional adjustments might be necessary. Additionally, RCAC recommends that the board and bookkeeper annually review the budget projections and modify it accordingly. We also recommend that every utility system review its rates once a year or more often if needed.

Ilfeld MDWCA 6-year Budget Projection

Line	FY 06 Year Actuals	FY 07 Annual Budget	FY 08	FY 09	FY 10	FY 11
REVENUE						
<u>Operating Revenues</u>						
1a	\$61,540.58	\$60,500.00	\$61,105.00	\$62,021.58	\$63,262.01	\$64,527.25
1b	\$0.00	1%	2%	2%	2%	3%
1c	\$0.00	\$605.00	\$916.58	\$1,240.43	\$1,265.24	\$1,613.18
1d	\$61,540.58	\$61,105.00	\$62,021.58	\$63,262.01	\$64,527.25	\$66,140.43
2a	\$8,500.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
2b	\$0.00	\$0.00	\$0.00	\$0.00	\$100.00	\$0.00
2c	\$515.23	\$200.00	\$200.00	\$200.00	\$200.00	\$200.00
2d	\$300.00	\$300.00	\$250.00	\$200.00	\$150.00	\$100.00
3	\$70,855.81	\$61,605.00	\$62,471.58	\$63,662.01	\$64,977.25	\$66,440.43
<u>Non-operating revenues</u>						
4	\$4.47	\$5.00	\$10.00	\$12.00	\$20.00	\$25.00
7	\$4.47	\$5.00	\$10.00	\$12.00	\$20.00	\$25.00
8	Total Revenue	\$70,860.28	\$61,610.00	\$62,481.58	\$63,674.01	\$64,997.25
9	Total O&M Expenses	\$28,124.96	\$40,758.00	\$41,980.74	\$43,240.16	\$44,537.37
10	Subtotal- Net Operating Income	\$42,735.32	\$20,852.00	\$20,500.84	\$20,433.84	\$20,591.94
	Debt Service	\$14,602.44	\$17,028.00	\$17,028.00	\$17,028.00	\$17,028.00
15	NET INCOME (LOSS) FROM OPERATIONS	\$28,132.88	\$3,824.00	\$3,472.84	\$3,405.84	\$3,563.94
16	Plus: Beginning Cash Balance	\$0.00	\$8,132.88	\$8,956.88	\$1,429.72	\$1,835.56
17	Ending Cash Balance Before Reserves	\$0.00	\$11,956.88	\$12,429.72	\$4,835.56	\$5,267.44

RESERVES

18	Debt Service Reserve	\$0.00		\$9,000.00	\$1,000.00	\$2,000.00	\$2,000.00
19	Capital Improvement Reserve	\$2,000.00		\$2,000.00	\$2,000.00	\$2,000.00	\$2,000.00
20	Emergency Reserve	\$10,000.00	\$3,000.00				
21	Operating Reserve	\$8,000.00					
22	Total Reserves	\$20,000.00	\$3,000.00	\$11,000.00	\$3,000.00	\$4,000.00	\$4,000.00
23	ENDING CASH BALANCE AFTER RESERVES	\$8,132.88	\$8,956.88	\$1,429.72	\$1,835.56	\$1,267.44	\$831.38

CUMULATIVE REVENUE AND RESERVE

24	DEFICIENCY (line 23 divided by line 10)	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
----	--	--------	--------	--------	--------	--------	--------

C:\Documents and Settings\bs\My Documents\Docs 2\Communities\Ilfield\Financials\Report Five Year Financial Plan 2007.doc