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To the Honorable City Council and Board of Public Utilities
City of Riverside
Riverside, California

INDEPENDENT AUDITORS' REPORT

We have audited the accompanying financial statements of the City of Riverside, California, Water Utility, an enterprise fund of the City, as of and for the year ended June 30, 2008 as listed in the table of contents. These financial statements are the responsibility of the City of Riverside Water Utility's management. Our responsibility is to express an opinion on these financial statements based on our audits. The prior year partial comparative information has been derived from the financial statements of the Water Utility for the year ended June 30, 2007 and, in our report dated October 19, 2007, we expressed an unqualified opinion on those financial statements.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1 to the financial statements, the financial statements of the City of Riverside, California, Water Utility are intended to present the financial position and the changes in financial position and cash flows for the City of Riverside, California, Water Utility, a fund of the City, and do not purport to, and do not, present fairly the financial position of the City of Riverside, California, and the changes in its financial position and its cash flows, where applicable, in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the City of Riverside, California, Water Utility, as of June 30, 2008 and the changes in its financial position and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As described further in Note 1 to the financial statements, the Water Utility changed its method of accounting for post employment benefits for the fiscal years ending on or after June 30, 2008.

The Management's Discussion and Analysis, as listed in the table of contents, is not a required part of the basic financial statements but is supplementary information. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.



To the Honorable City Council and Board of Public Utilities
City of Riverside

Our audits were conducted for the purpose of forming an opinion on the financial statements that comprise the City of Riverside, California, Water Utility's basic financial statements. The supplementary information entitled Water Key Historical Data, as listed in the table of contents, is presented for the purpose of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audits of the basic financial statements and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 3, 2008 on our consideration of the City of Riverside's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Mayor Helman McLean

Irvine, California
October 3, 2008

MANAGEMENT'S DISCUSSION AND ANALYSIS: WATER

As management of Riverside Public Utilities (a department of the City of Riverside), we offer the readers of Riverside's Water Utility financial statements, an enterprise fund of the City, this narrative overview and analysis of the financial activities of the Water Utility (Utility) for the fiscal years ended June 30, 2008 and 2007. We encourage readers to consider the information presented here in conjunction with additional information furnished in our financial statements, which begin on page 52 of this report. All amounts, unless otherwise indicated, are expressed in thousands of dollars.

FINANCIAL HIGHLIGHTS

Fiscal years 2008 and 2007 reflected strong operating results for the Water Utility, with retail sales exceeding the previous year's results, primarily from an expanded customer base and the effects of rate increases offset by a decrease in consumption.

- Retail sales, net of reserve/recovery were \$46,164 and \$43,403 for the years ended June 30, 2008 and 2007, respectively. The increase in sales was primarily due to recent rate increases to support the Water Utility's Water Master, Water Supply and Asset Management Plans.
- In May 2008, Standard & Poor's raised the City of Riverside's Water Utility's revenue bonds to AA+ from its previous rating of AA.
- The assets of the Water Utility exceeded its liabilities (equity) at the close of fiscal years 2008 and 2007 by \$274,487 and \$253,917, respectively. Of this amount, \$37,884 and \$39,707, respectively, may be used to meet the Utility's ongoing obligations to creditors and customers.
- The Utility's total equity as of June 30, 2008 and 2007 increased by \$20,570 and \$25,037 from fiscal years ended June 30, 2007 and 2006, respectively.
- As of June 30, 2008 and 2007, unrestricted equity represented over 88% and 106% of annual operating expenses, respectively.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the City of Riverside Water Utility financial statements. The Water Utility is a department of the City of Riverside, and its activities are recorded in a separate enterprise fund. These financial statements include only the activities for the City of Riverside Water Utility and provide comparative information for the last two fiscal years. Information on city-wide financial results is available in the City of Riverside's "Comprehensive Annual Financial Report."

The City of Riverside Water Utility's financial statements comprise two components: 1) financial statements, and 2) notes to the financial statements. In addition, this report also contains other supplementary information to provide the reader additional information about the Water Utility, including key historical operating and other relevant data.

Included as part of the financial statements are three separate statements, which collectively provide an indication of the Water Utility's financial health.

The **Balance Sheets** present information on assets and liabilities, with the difference between the two reported as equity. Over time, increases or decreases in equity may serve as a useful indicator of whether the financial condition of the Utility is improving or deteriorating.

The **Statements of Revenues, Expenses and Changes in Equity** present information showing how the Utility's equity changed during the most recent two fiscal years. Results of operations are reported as underlying events occur, regardless of the timing of cash flows. Thus, revenues and expenses are reported in these statements for some items that will result in cash flows in future fiscal periods, e.g., accounts payable and accounts receivable. This is called the accrual basis of accounting and is more fully described in the accompanying Notes to the Financial Statements.

MANAGEMENT'S DISCUSSION AND ANALYSIS: WATER

The **Statements of Cash Flows** present the cash flow changes occurring during the last two fiscal years in highly liquid cash and cash equivalents, including certain restricted assets.

The **Notes to the Financial Statements** provide additional information that is essential to a full understanding of the data provided in the Water Utility's financial statements. The notes to the financial statements can be found on pages 56 to 67 of this report.

UTILITY FINANCIAL ANALYSIS

As noted earlier, equity (also called net assets) may serve over time as a useful indicator of the fund's financial position. In the case of Riverside's Water Utility, assets exceeded liabilities by \$274,487 and \$253,917 at the close of the fiscal years 2008 and 2007, respectively.

The following table summarizes the Water Utility's financial condition as of June 30, 2008, 2007 and 2006:

CONDENSED STATEMENTS OF EQUITY (NET ASSETS)

	2008	2007	2006
Current and other assets	\$ 117,858	\$ 77,827	\$ 86,812
Capital assets	324,636	286,396	254,425
Total assets	442,494	364,223	341,237
Long-term debt outstanding	147,349	91,568	94,961
Other liabilities	20,658	18,738	17,396
Total liabilities	168,007	110,306	112,357
Invested in capital assets, net of related debt	230,347	208,882	188,774
Restricted	6,256	5,328	4,762
Unrestricted	37,884	39,707	35,344
Total equity (net assets)	\$ 274,487	\$ 253,917	\$ 228,880

ASSETS

Fiscal Year 2008 Total assets of \$442,494 reflect an increase of \$78,271 (21.5%), mainly due to the following:

- Current and other assets, which are comprised of restricted and unrestricted assets, reflect a net increase of \$40,031 due to the issuance of the 2008 Water Revenue Series B Bonds which resulted in an increase in bond proceeds of \$60,000 to fund construction projects offset by the use of \$20,536 of bond proceeds for capital projects. Operating cash decreased by \$10,550 primarily due to \$10,300 of capital construction projects eligible for reimbursement from the State.
- The increase in net capital assets (Utility plant) of \$38,240 was a result of significant expenses in the pipeline replacement program, system expansion and improvements, and the contribution of treatment facilities as discussed in the "Capital Assets and Debt Administration" section on page 50 of this report.

Fiscal Year 2007 Total assets of \$364,223 reflect an increase of \$22,986 (6.7%), due to a \$31,971 increase in net capital assets (Utility plant) primarily relating to improvements to the Water Utility's distribution system and treatment facilities, and an \$8,985 net decrease in current and other assets. The \$8,985 was comprised of a \$14,124 decrease in restricted assets mainly due to the use of bond proceeds for capital projects, offset by a \$5,139 increase in unrestricted assets largely resulting from positive operating results.

MANAGEMENT'S DISCUSSION AND ANALYSIS: WATER

LIABILITIES

Fiscal Year 2008 The Utility's total liabilities were \$168,007, an increase of \$57,701 (52.3%), due to the following:

- Long-term debt outstanding increased by \$55,781 primarily due to the issuance of the 2008 Water Revenue Series B Bonds in the amount of \$58,235, offset by \$4,364 of principal repayments, and the amortization of deferred bond refunding costs, capital appreciation, and bond discounts and premiums.
- Other liabilities increased by \$1,920, primarily from a \$2,609 increase in accounts payable and accrued liabilities, offset by a decrease in customer deposits of \$717 due to the distribution of deposits to shareholders held on behalf of the La Sierra Water Company.

Fiscal Year 2007 The Utility's total liabilities decreased by \$2,051 (1.8%) to \$110,306. Long-term debt outstanding decreased by \$3,393 largely due to principal repayments, and other liabilities increased by \$1,342 due to an increase in accounts payable.

EQUITY (NET ASSETS)

Fiscal Year 2008 The Water Utility's equity, which represents the difference between the Utility's resources and its obligations, totaled \$274,487, an increase of \$20,570 (8.1%), comprised of the following:

- The largest portion of the Utility's equity is \$230,347 (83.9%), and reflects its investment in capital assets, such as treatment, pumping, source of supply, transmission and distribution facilities, less any related outstanding debt used to acquire those assets. This portion increased by \$21,465 (10.3%) over prior fiscal year due to the amount of capital assets constructed or purchased that were not bond financed. The Water Utility uses these capital assets to provide services to customers; consequently, these assets are not available for future spending. Resources needed to repay the outstanding debt shown on the Balance Sheets must come from other sources such as operations, since the capital assets themselves cannot be used to liquidate these long-term obligations. Additional capital asset information can be found in the "Capital Assets and Debt Administration" section.
- The restricted portion totaled \$6,256 (2.3% of total equity), and represents resources that are subject to internal and external restrictions on how they may be used. These are reserved for items such as debt repayment and funds collected for the Water Conservation and Reclamation programs. This portion increased by \$928 from prior fiscal year primarily due to increases in Water Conservation and Reclamation program assets.
- The unrestricted portion totaled \$37,884 (13.8% of total equity), a decrease of \$1,823, primarily attributable to results of positive operations offset by the use of unrestricted equity to fund capital projects and additional debt service reserves in the current fiscal year. This portion may be used to meet the Utility's ongoing obligations to creditors and customers.

Fiscal Year 2007 Total Water fund equity increased \$25,037 (10.9%) to \$253,917. The largest portion of the equity, \$208,882 (82.3%), is represented by investment in capital assets, which increased by \$20,108 (10.7%) due to the amount of capital assets constructed or purchased that were not bond funded. The restricted portion increased by \$566 primarily due to increases in Water Conservation and Reclamation program assets. The unrestricted portion increased by \$4,363 due to positive operating results for fiscal year 2007.

MANAGEMENT'S DISCUSSION AND ANALYSIS: WATER

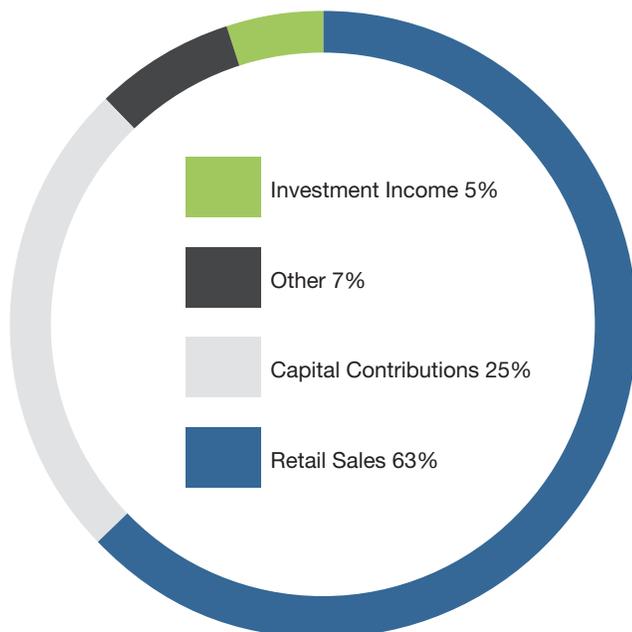
The Water Utility's overall increase in equity of \$20,570 and \$25,037 during fiscal years 2008 and 2007, respectively, was due to positive operating results and is reflected in the following Condensed Statements of Changes in Equity:

CONDENSED STATEMENTS OF CHANGES IN EQUITY (NET ASSETS)

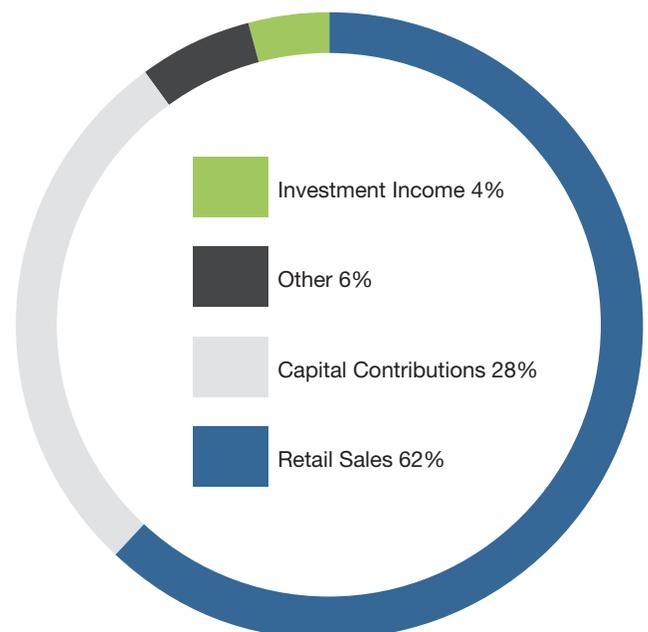
	2008	2007	2006
Revenues:			
Retail sales, net	\$ 46,164	\$ 43,403	\$ 34,301
Other revenues	5,206	4,491	19,708
Investment income	3,357	2,931	1,773
Capital contributions	18,116	20,074	16,511
Total revenues	72,843	70,899	72,293
Expenses:			
Operations and maintenance	27,795	23,449	21,514
Purchased energy and water	6,316	6,233	5,742
Depreciation	8,806	7,783	7,142
Interest expense and fiscal charges	4,401	4,469	4,959
Total expenses	47,318	41,934	39,357
Transfers to the City's general fund	(4,955)	(3,928)	(3,539)
Changes in equity	20,570	25,037	29,397
Equity, July 1	253,917	228,880	199,483
Equity, June 30	\$ 274,487	\$ 253,917	\$ 228,880

REVENUES BY SOURCES

June 30, 2008



June 30, 2007



MANAGEMENT'S DISCUSSION AND ANALYSIS: WATER

Fiscal Year 2008 Total revenues of \$72,843 increased by \$1,944 (2.7%) from prior fiscal year, due to the following major changes:

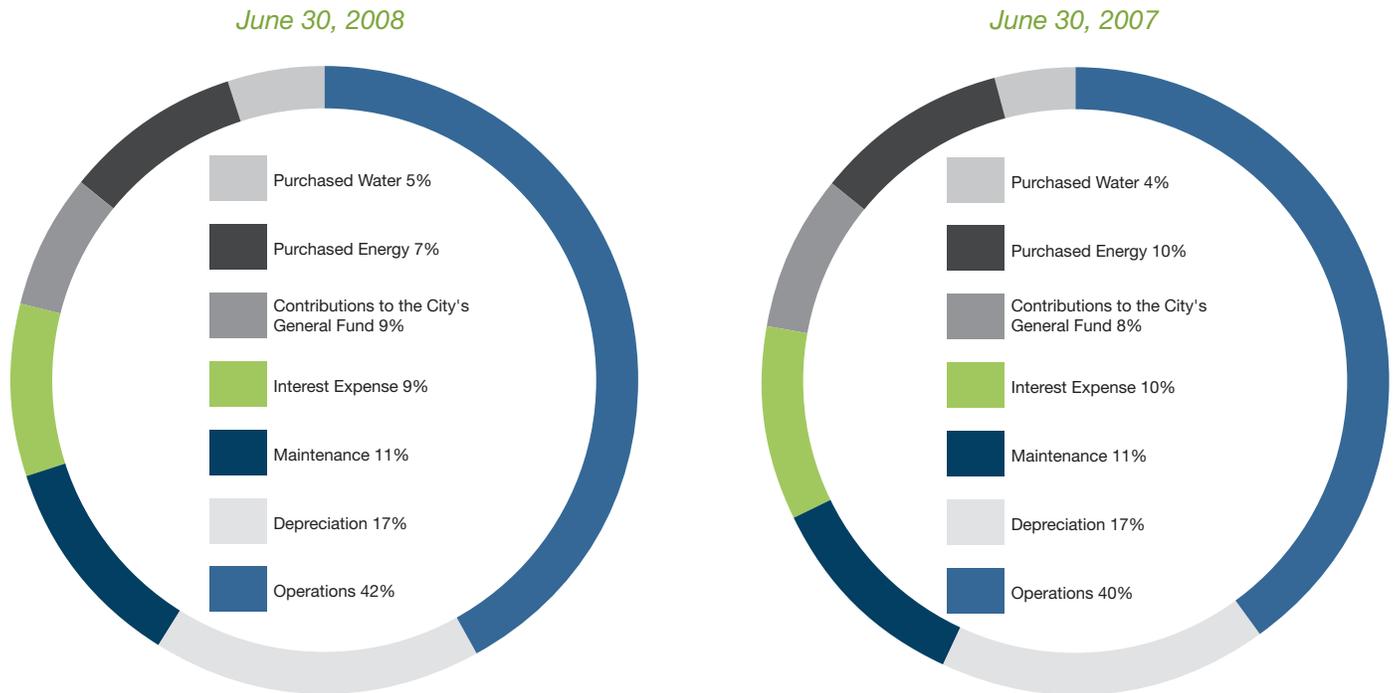
- Retail sales (residential, commercial, industrial, and other sales), net of reserve/recovery, totaled \$46,164, an increase of \$2,761 (6.4%) over the prior fiscal year. Retail sales continue to be the primary revenue source for the Water Utility, making up 63.4% of total revenues. The increase in retail sales was primarily due to a 10.0% rate increase that became effective November 1, 2007 as part of the SAFE W.A.T.E.R. (Water Available to Everyone in Riverside) Plan, offset by a 6.1% decrease in retail consumption.
- Other revenues of \$5,206 increased by \$715 (15.9%) predominantly due to increases in wholesale sales, land and building rental, and gain on the sale of assets.
- Investment income of \$3,357 reflects an increase of \$426 (14.5%), due to an overall net increase in the fair market value of investments.
- Capital contributions were \$18,116 and reflect a decrease of \$1,958 (9.8%), primarily due to an increase of \$10,047 in contributions from State grants for reimbursable capital project costs, offset by a decrease of \$6,168 in non-cash contributions for treatment facilities from settlement agreements with parties responsible for contaminating the Water Utility's ground water resources and a decrease of \$5,837 in construction projects funded by developers.

Fiscal Year 2007 Total revenues of \$70,899 decreased by \$1,394 (1.9%) from prior fiscal year, due to the following major changes:

- Net retail sales were \$43,403, making up 61.2% of total revenues. Net retail sales increased \$9,102 (26.5%) due to an 8.5% rate increase that became effective June 1, 2006, a 12% rate increase that became effective November 1, 2006 as part of the SAFE W.A.T.E.R. Plan, and an 11.3% increase in retail consumption.
- Other revenues of \$4,491 decreased by \$15,217 (77.2%) predominantly due to \$15,384 received from the sale of surplus property in the previous fiscal year.
- Capital contributions of \$20,074 reflect an increase of \$3,563 (21.6%), primarily due to a non-cash contribution of \$7,243 for treatment facilities from settlement agreements, offset by a decrease of \$5,598 in construction projects funded by developers.
- Investment income of \$2,931 reflects an increase of \$1,158 (65.3%), due to an increase in operating cash and an overall net increase in the fair market value of investments.

MANAGEMENT'S DISCUSSION AND ANALYSIS: WATER

EXPENSES BY SOURCES



Fiscal Year 2008 Total expenses were \$47,318, an increase of \$5,384 (12.8%), due to the items discussed below:

- Operations and maintenance costs were \$27,795, and reflect an increase of \$4,346 (18.5%), largely due to an increase in personnel-related expenses, professional service costs and general operating expenses.
- Depreciation expense of \$8,806 increased \$1,023 (13.1%) due to the purchase of equipment of \$2,407 and the completion of capital projects of \$36,200 that were included as depreciable capital assets.

Fiscal Year 2007 Total expenses were \$41,934, reflecting an increase of \$2,577 (6.5%), due to an increase in labor costs, professional service costs, maintenance expenses and the cost of electricity and gas necessary for operations, offset by a reduction in purchased water costs.

TRANSFERS

Transfers to the City's general fund are limited to a maximum of 11.5% of the prior year gross operating revenues by Section 1204(f) of the City Charter. The City uses these funds to help provide needed public services to the residents of the City, including police, fire, parks, libraries and other benefits.

Fiscal Year 2008 The Water Utility transferred the maximum allowable by the City Charter to the City's general fund, or \$4,955, an increase of \$1,027, primarily the result of a \$9,102 increase in retail sales for fiscal year 2007.

Fiscal Year 2007 Transfers to the City's general fund of \$3,928 increased by \$389, primarily the result of increased retail sales of \$3,547 for fiscal year 2006.

MANAGEMENT'S DISCUSSION AND ANALYSIS: WATER

CAPITAL ASSETS AND DEBT ADMINISTRATION

CAPITAL ASSETS

The Water Utility's investment in capital assets includes investments in source of supply, pumping, treatment, transmission and distribution facilities, and construction in progress, as well as general items such as office equipment, furniture, etc.

The following table summarizes the Utility's capital assets, net of depreciation as of June 30:

	2008	2007	2006
Source of supply	\$ 24,719	\$ 22,266	\$ 22,727
Pumping	11,451	7,641	7,918
Treatment	20,613	20,293	13,483
Transmission and distribution	217,071	195,557	190,708
General	5,253	3,680	3,066
Land	7,682	3,923	3,891
Intangible	5,969	5,969	5,969
Construction in progress	31,878	27,067	6,663
Total	<u>\$ 324,636</u>	<u>\$ 286,396</u>	<u>\$ 254,425</u>

Fiscal Year 2008 The Water Utility's investment in capital assets, net of accumulated depreciation, was \$324,636 an increase of \$38,240 (13.4%). The increase resulted primarily from the following significant capital projects:

- \$6,156 for continued pipeline replacement programs.
- \$10,768 for system expansion and improvements including pump station replacements and facilities rehabilitation.
- \$20,463 for John W. North Treatment facility which will greatly increase the water supply and part of the recommended improvements in the SAFE W.A.T.E.R. Plan.
- \$1,075 from non-cash contributions for treatment facilities from settlement agreements with parties responsible for contaminating the Water Utility's ground water resources.
- \$2,541 for property acquisitions for future reservoirs, booster stations and other system expansion or improvements projects.

Fiscal Year 2007 Investment in capital assets, net of accumulated depreciation, for the Water Utility increased \$31,971 (12.6%), for a total of \$286,396. Major capital projects included \$11,279 for continued pipeline replacement programs, \$10,045 for system expansion and improvements to water facilities and \$7,243 from non-cash contributions for treatment facilities.

DEBT ADMINISTRATION

The following table summarizes outstanding long-term debt (revenue bonds) as of June 30:

	2008	2007	2006
Revenue bonds	\$ 153,395	\$ 99,515	\$ 103,815
Contracts payable	964	974	979
Less:			
Current portion	(4,525)	(4,505)	(4,450)
Unamortized deferred bond refunding costs	(3,198)	(2,510)	(2,587)
Unamortized capital appreciation	(938)	(1,629)	(2,487)
Unamortized bond premium (discount)	1,651	(277)	(309)
Total	<u>\$ 147,349</u>	<u>\$ 91,568</u>	<u>\$ 94,961</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS: WATER

The Water Utility's bond indentures require the Utility to maintain a minimum debt service coverage ratio, as defined by the bond covenants, of 1.25. The Water Utility's debt service coverage ratio was 3.88, 3.38, and 5.11 at June 30, 2008, 2007, and 2006, respectively. The debt is backed by the revenues of the Utility (revenue bonds).

Fiscal Year 2008 Total long-term debt increased by \$55,781 (60.9%) to a total of \$147,349, due to the May 15, 2008 issuance of the 2008 Water Revenue Series B Bonds in the amount of \$58,235, offset by \$4,364 of principal repayments, and the amortization of deferred bond refunding costs, capital appreciation, and bond discounts and premiums. In May 2008, the Utility also issued the 2008 Water Refunding/Revenue Series A Bonds to advance refund the 2005 Water Refunding/Revenue Bonds.

Fiscal Year 2007 Long-term debt of \$91,568 decreased by \$3,393 (3.6%), due to repayment of principal on outstanding revenue bonds and the amortization of deferred bond refunding costs, capital appreciation and bond discounts.

Additional information on the Water Utility's long-term debt can be found in Note 4 on pages 62 to 66 of this report.

CREDIT RATINGS

In May 2008, Standard & Poor's raised the rating of the Water Utility's water bonds to "AA+" from "AA" and cited the Utility's "continued strong financial management, minimal capital needs, and a growing service area economy," as rational.

The Water Utility maintains an "AA" credit rating from Fitch Ratings for its revenue bonds.

ECONOMIC FACTORS AND RATES

Although inflationary trends in the Riverside region continue to compare favorably to the national indices, the Water Utility's escalation in costs are not strictly attributable to inflation. One of the primary drivers of the increase in costs relates to the Water Utility's aging infrastructure.

To address this concern, in March 2006, the Board of Public Utilities, after the requisite public hearing, adopted and the City Council unanimously approved the SAFE W.A.T.E.R. Plan. This plan implements system improvements contained in the Water Master, Water Supply and Asset Management Plans. The SAFE W.A.T.E.R. Plan is initially funded by a fifty-two percent, five-year water rate increase, consisting of a twelve percent and four-ten percent increases effective November 1, 2006, 2007, 2008, 2009, and 2010, respectively.

In addition to inflation, management continually plans for and identifies issues or potential contingencies that could impact future rates such as reclaimed water, infrastructure needs, system growth, source of supply, ground water contamination, stricter contaminant guidelines, legislative mandates, and others. In an effort to control costs to its customers, the Utility is aggressive in pursuing outside parties, and holding them responsible for any negative effects they may cause to Riverside's water quality.

REQUESTS FOR INFORMATION

This financial report is designed to provide a general overview of the City of Riverside Water Utility's finances. Questions concerning any information provided in this report or requests for additional financial information should be addressed to the Assistant General Manager Finance and Customer Relations or the Utilities Finance/Rates Manager, Riverside Public Utilities, 3901 Orange Street, Riverside, CA 92501. Additional financial information can also be obtained by visiting www.riversidepublicutilities.com.

BALANCE SHEETS: WATER

ASSETS	June 30, 2008	June 30, 2007
	(in thousands)	
UTILITY PLANT:		
Source of supply	\$ 35,880	\$ 32,822
Pumping	18,219	14,053
Treatment	23,772	22,697
Transmission and distribution	311,288	284,010
General	12,288	10,045
	<u>401,447</u>	<u>363,627</u>
Less accumulated depreciation	(122,340)	(114,190)
	<u>279,107</u>	<u>249,437</u>
Land	7,682	3,923
Intangible	5,969	5,969
Construction in progress	31,878	27,067
	<u>324,636</u>	<u>286,396</u>
Total utility plant (Note 3)		
RESTRICTED ASSETS:		
Cash and cash equivalents (Note 2)	4,862	4,475
Cash and investments at fiscal agent (Note 2)	56,694	17,982
	<u>61,556</u>	<u>22,457</u>
Total restricted non-current assets		
OTHER NON-CURRENT ASSETS:		
Deferred pension costs	5,782	5,838
Deferred bond issuance costs	1,702	1,003
Advances to the City's general fund	-	20
	<u>7,484</u>	<u>6,861</u>
Total other non-current assets		
Total non-current assets	<u>393,676</u>	<u>315,714</u>
CURRENT ASSETS:		
<i>Unrestricted assets:</i>		
Cash and cash equivalents (Note 2)	29,577	40,127
Accounts receivable, less allowance for doubtful accounts 2008 \$121; 2007 \$58	5,860	5,290
Accounts receivable, other utilities and governments, less allowance for doubtful accounts 2008 \$179; 2007 \$155	11,718	1,838
Accrued interest receivable	260	399
Prepaid expenses	6	2
	<u>47,421</u>	<u>47,656</u>
Total unrestricted current assets		
<i>Restricted assets:</i>		
Cash and cash equivalents (Note 2)	1,249	741
Conservation and Reclamation Programs receivable	148	112
	<u>1,397</u>	<u>853</u>
Total restricted current assets		
Total current assets	<u>48,818</u>	<u>48,509</u>
Total assets	<u>\$ 442,494</u>	<u>\$ 364,223</u>

* See accompanying notes to the financial statements

BALANCE SHEETS: WATER

EQUITY AND LIABILITIES	June 30, 2008	June 30, 2007
	(in thousands)	
EQUITY:		
Invested in capital assets, net of related debt	\$ 230,347	\$ 208,882
Restricted for:		
Debt service (Note 5)	4,862	4,475
Conservation and Reclamation Programs	1,394	853
Unrestricted	37,884	39,707
Total equity	<u>274,487</u>	<u>253,917</u>
LONG-TERM OBLIGATIONS, LESS CURRENT PORTION (NOTE 4)	<u>147,349</u>	<u>91,568</u>
OTHER NON-CURRENT LIABILITIES:		
Pension obligation (Note 4)	5,682	5,761
Postemployment benefits payable	129	-
Arbitrage liability	-	416
Total other non-current liabilities	<u>5,811</u>	<u>6,177</u>
CURRENT LIABILITIES PAYABLE FROM RESTRICTED ASSETS:		
Accrued interest payable	568	318
Conservation and Reclamation Programs payable	3	-
Current portion of long-term debt (Note 4)	4,375	4,355
Total current liabilities payable from restricted assets	<u>4,946</u>	<u>4,673</u>
CURRENT LIABILITIES:		
Accounts payable	6,862	4,436
Accrued liabilities	2,142	1,959
Current portion of long-term debt (Note 4)	150	150
Current portion postemployment benefits payable (Note 4)	121	-
Customer deposits	626	1,343
Total current liabilities	<u>9,901</u>	<u>7,888</u>
Total liabilities	<u>168,007</u>	<u>110,306</u>
COMMITMENTS AND CONTINGENCIES (NOTES 6 AND 7)	-	-
Total equity and liabilities	<u>\$ 442,494</u>	<u>\$ 364,223</u>

* See accompanying notes to the financial statements

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN EQUITY: WATER

For the Fiscal Years
Ended June 30,
2008 2007
(in thousands)

	2008	2007
OPERATING REVENUES:		
Residential sales	\$ 30,046	\$ 28,396
Commercial sales	14,615	13,255
Other sales	1,755	1,916
Wholesale sales	206	164
Conservation and Reclamation Programs	825	737
Other operating revenue	2,408	2,602
Total operating revenues before (reserve)/recovery	49,855	47,070
Reserve for uncollectible, net of bad debt recovery	(252)	(164)
Total operating revenues, net of (reserve)/recovery	49,603	46,906
OPERATING EXPENSES:		
Operations	21,971	18,382
Maintenance	5,540	4,846
Purchased energy	3,650	4,534
Purchased water	2,666	1,699
Conservation and Reclamation Programs	284	221
Depreciation	8,806	7,783
Total operating expenses	42,917	37,465
Operating income	6,686	9,441
NON-OPERATING REVENUES (EXPENSES):		
Investment income	3,357	2,931
Interest expense and fiscal charges	(4,401)	(4,469)
Gain (loss) on sale of capital assets	164	(144)
Gain on sale of land	12	70
Other	1,591	1,062
Total non-operating revenues (expenses)	723	(550)
Income before contributions and transfers	7,409	8,891
Capital contributions	18,116	20,074
Transfers out - contributions to the City's general fund	(4,955)	(3,928)
Total capital contributions and transfers out	13,161	16,146
Increase in equity	20,570	25,037
EQUITY, BEGINNING OF YEAR	253,917	228,880
EQUITY, END OF YEAR	\$ 274,487	\$ 253,917

* See accompanying notes to the financial statements

STATEMENTS OF CASH FLOWS: WATER

For the Fiscal Years
Ended June 30,
2008 2007
(in thousands)

	2008		2007
CASH FLOWS FROM OPERATING ACTIVITIES:			
Cash received from customers and users	\$ 48,533	\$	47,781
Cash paid to suppliers and employees	(31,450)		(28,445)
Other receipts	1,591		1,062
Net cash provided by operating activities	18,674		20,398
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES:			
Transfers out - contributions to the City's general fund	(4,955)		(3,928)
Principal paid on pension obligation bonds	(79)		(62)
Net cash used by non-capital financing activities	(5,034)		(3,990)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:			
Purchase of utility plant	(42,031)		(25,469)
Proceeds from the sale of utility plant	306		103
Principal paid on long-term obligations	(4,364)		(4,305)
Interest paid on long-term obligations	(3,820)		(3,445)
Proceeds from revenue bonds, including premium	120,430		-
Deposit to escrow account for advance bond refunding	(60,300)		-
Bond issuance costs	(1,435)		-
Capital contributions	3,531		5,611
Net cash provided (used) by capital and related financing activities	12,317		(27,505)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Reduction in advances to the City's general fund	20		8
Purchases of investment securities	27		(430)
Income from investments	3,080		3,276
Net cash provided by investing activities	3,127		2,854
Net increase (decrease) in cash and cash equivalents	29,084		(8,243)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR (including \$14,722 and \$29,327 at June 30, 2007 and June 30, 2006, respectively, reported in restricted accounts)			
	54,849		63,092
CASH AND CASH EQUIVALENTS, END OF YEAR (including \$54,356 and \$14,722 at June 30, 2008 and June 30, 2007, respectively, reported in restricted accounts)			
	\$ 83,933	\$	54,849
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:			
Operating income	\$ 6,686	\$	9,441
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation	8,806		7,783
Amortization of deferred charges-pension costs	56		38
Increase (decrease) in allowance for uncollectible accounts	87		(38)
Decrease (increase) in accounts receivable	(693)		806
Decrease (increase) in prepaid expenses	(4)		366
Increase in accounts payable	2,427		1,188
Increase (decrease) in accrued liabilities	183		(191)
Increase in postemployment benefits payable	250		-
(Decrease) in customer deposits	(715)		(57)
Other receipts	1,591		1,062
Net cash provided by operating activities	\$ 18,674	\$	20,398
SCHEDULE OF NON-CASH INVESTING, CAPITAL AND FINANCING ACTIVITIES:			
Capital contributions - capital assets	4,706		14,463
Increase (decrease) in fair value of investments	(1)		23

* See accompanying notes to the financial statements

NOTES TO THE FINANCIAL STATEMENTS: WATER

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Water Utility exists under, and by virtue of, the City Charter enacted in 1883. The Water Utility is responsible for the production, transmission and distribution of water for sale in the City, except for certain areas served by another water utility.

BASIS OF ACCOUNTING

The Water Utility uses the accrual basis of accounting as required for enterprise funds with accounting principles generally accepted in the United States of America as applicable to governments. The accounting records of the Water Utility are also in conformity with the Uniform System of Accounts prescribed by the California Public Utilities Commission. The Water Utility is not subject to the regulations of the California Public Utilities Commission. The Water Utility is not required to and does not elect to implement the pronouncements of the Financial Accounting Standards Board issued after November 1989.

USE OF ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the reported amounts of revenues and expenses during a reporting period. Actual results could differ from those estimates.

REVENUE RECOGNITION

Water Utility customers are billed monthly. Unbilled water service charges are recorded at year-end and are included in accounts receivable. Unbilled accounts receivable totaled \$2,961 at June 30, 2008, and \$2,732 at June 30, 2007.

An allowance for doubtful accounts is maintained for utility and miscellaneous accounts receivable. The balance in this account is adjusted at fiscal year-end to approximate the amount anticipated to be uncollectible.

UTILITY PLANT AND DEPRECIATION

Utility plant assets are valued at historical costs or estimated historical cost, if actual historical cost is not available. Costs include labor; materials; interest during construction; allocated indirect charges such as engineering, supervision, construction and transportation equipment, retirement plan contributions and other fringe benefits. Contributed plant assets are valued at estimated fair value on the date contributed. The cost of relatively minor replacements is included in maintenance expense.

Depreciation is recorded over the estimated useful lives of the related assets using the straight-line method. The estimated useful lives are as follows:

Supply, pumping and treatment plant.....	15-60 years
Transmission and distribution plant.....	25-50 years
General plant and equipment.....	3-50 years

RESTRICTED ASSETS

Proceeds of revenue bonds yet to be used for capital projects, as well as certain resources set aside for debt service, are classified as restricted assets on the Balance Sheets because their use is limited by applicable bond covenants.

In June 2004, the City began collecting a surcharge for water conservation and reclamation programs. This surcharge was approved by the City Council and was phased in over a three-year period with a 0.5%, 1.0% and 1.5% surcharge effective June 1, 2004, 2005 and 2006, respectively. The programs and services offered include conservation, education, and water use efficiency programs; programs to encourage the use of reclaimed water; research, development and demonstration programs to advance science and technology with respect to water conservation and reclamation; and water service provided to low-income customers. This surcharge is scheduled to be in effect for services rendered on or after June 1, 2004 through May 31, 2014. The activity associated with the surcharge for water conservation and reclamation programs is reflected in the accompanying financial statements on the Balance Sheets, Statements of Revenues, Expenses and Changes in Equity, and Statements of Cash Flows.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

CASH AND INVESTMENTS

In accordance with Water Utility policy, the Water Utility's cash and investments, except for cash and investments with fiscal agents, are invested in a pool managed by the Treasurer of the City. The Water Utility does not own specific, identifiable investments of the pool. The pooled interest earned is allocated monthly based on the month end cash balances.

The City values its cash and investments in accordance with provisions of Governmental Accounting Standards Board (GASB) Statement No. 31, "Accounting and Financial Reporting for Certain Investments and External Investment Pools (GASB 31)," which requires governmental entities, including governmental external investment pools, to report certain investments at fair value in the Statements of Net Assets/Balance Sheets and recognize the corresponding change in the fair value of investments in the year in which the change occurred. Fair value is determined using published market prices.

Cash accounts of all funds are pooled for investment purposes to enhance safety and liquidity while maximizing interest earnings. Investments are stated at fair value.

City-wide information concerning cash and investments for the year ended June 30, 2008, including authorized investments, custodial credit risk, credit and interest rate risk for debt securities and concentration of investments, carrying amount and market value of deposits and investments may be found in the notes to the City's "Comprehensive Annual Financial Report."

CASH AND INVESTMENTS AT FISCAL AGENTS

Cash and investments maintained by fiscal agents are considered restricted by the Utility and are pledged as collateral for payment of principal and interest on outstanding bonds, or for use on construction of capital assets.

BOND PREMIUM/DISCOUNTS, CAPITAL APPRECIATION, ISSUANCE COSTS, GAINS AND LOSSES ON REFUNDING

Bond premium/discounts, capital appreciation, issuance costs and gains and losses on refunding are deferred and amortized over the term of the bonds using the effective interest method. Bond premium/discounts, capital appreciation, and gains and losses on refunding are presented as a reduction of the face amount of bonds payable, whereas issuance costs are recorded as other assets. Capital appreciation is the annual increase in the value of bonds originally issued at a discounted amount. These bonds do not pay annual interest and mature at a pre-determined par value.

CUSTOMER DEPOSITS

The City holds customer deposits as security for the payment of utility bills. The Water Utility's portion of these deposits as of June 30, 2008 and 2007, respectively, was \$626 and \$1343 (including \$104 and \$969, respectively, held on behalf of La Sierra Water Company pending dissolution and distribution of remaining cash asset to shareholders, of which the City is the largest owner).

COMPENSATED ABSENCES

The accompanying financial statements include accruals for salaries, fringe benefits and compensated absences due employees at June 30, 2008 and 2007. The Water Utility treats compensated absences due employees as an expense and a current liability. The amount accrued for compensated absences was \$1,993 at June 30, 2008, and \$1,899 at June 30, 2007, and is included in accrued liabilities in the accompanying Balance Sheets.

Employees receive 10 to 25 vacation days per year based upon length of service. A maximum of two years vacation accrual may be accumulated and unused vacation is paid in cash upon separation.

Employees primarily receive one day of sick leave for each month of employment with unlimited accumulation. Upon retirement or death, certain employees or their estates receive a percentage of unused sick leave paid in a lump sum based on longevity.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

INSURANCE PROGRAMS

The Water Utility participates in a self-insurance program for workers' compensation and general liability coverage that is administered by the City. The Water Utility pays an amount to the City based on actuarial estimates of the amounts needed to fund prior and current year claims and incidents that have been incurred but not reported. The City maintains property insurance on most City property holdings, including Utility plant with a limit of \$100,000.

City-wide information concerning risks, insurance policy limits and deductibles and designation of general fund balance for risks for the year ended June 30, 2008, may be found in the notes to the City's "Comprehensive Annual Financial Report."

Although the ultimate amount of losses incurred through June 30, 2008 is dependent upon future developments, management believes that amounts paid to the City are sufficient to cover such losses. Premiums paid to the City by the Water Utility were \$490 and \$219 for the years ended June 30, 2008 and 2007, respectively. Any losses above the City's reserves would be covered through increased rates charged to the Water Utility in future years.

EMPLOYEE RETIREMENT PLAN

The City contributes to the California Public Employees Retirement System (PERS), an agent multiple-employer public employee retirement system that acts as a common investment and administrative agency for participating public entities within the State of California.

All permanent full-time and selected part-time employees are eligible for participation in PERS. Benefits vest after five years of service and are determined by a formula that considers the employee's age, years of service and salary. Employees may retire at age 55 and receive 2.7 percent of their highest annual salary for each year of service completed. PERS also provides death and disability benefits. These benefit provisions and all other requirements are established by state statute and City ordinance.

Employee contributions are 8.0 percent of their annual covered salary. The Water Utility is required to contribute the remaining amounts necessary to fund the benefits for its employees using the actuarial basis recommended by the PERS actuaries and actuarial consultants and adopted by the PERS Board of Administration. The employer portion of PERS funding as of June, 30 2008 and 2007, was 13.29 percent and 13.18 percent, respectively, of annual covered payroll. The Water Utility pays both the employee and employer contributions. The total Water Utility's contribution to PERS as of June 30, 2008 and 2007, was \$1,842 and \$1,579, respectively.

City-wide information concerning elements of the unfunded actuarial accrued liabilities, contributions to PERS for the fiscal year ended June 30, 2008, and recent trend information may be found in the notes to the City's "Comprehensive Annual Financial Report" for the fiscal year ended June 30, 2008.

PENSION OBLIGATION BONDS

In 2005, the City issued Pension Obligation Bonds in the amount of \$60,000, of which the Water Utility's share is \$5,890 as reflected in the accompanying Balance Sheet as deferred pension costs and a corresponding long-term obligation. The deferred charge relating to the net pension asset will be amortized over 19 years in accordance with the method used by PERS for calculating actuarial gains and losses. The Bonds will be used to fund the unfunded actuarial accrued liability for non-safety employees and the proceeds were deposited with PERS. The balance in deferred pension costs as of June 30, 2008 and 2007 was \$5,782 and \$5,838, respectively. For more discussion relating to the City's issue, see the notes to the City's "Comprehensive Annual Financial Report" for the fiscal year ended June 30, 2008.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

OTHER POST-EMPLOYMENT BENEFITS

The City contributes to two single-employer defined benefit healthcare plans: Stipend Plan (SP) and the Implied Subsidy Plan (ISP). The plans provide other postemployment health care benefits (OPEB) for eligible retirees and beneficiaries.

The Stipend Plan is available to eligible retirees and beneficiaries pursuant to their collective bargaining agreements. The Water Utility currently contributes to a bargaining unit through the Service Employee's International Union General Trust (SEIUG). Benefit provisions for the Stipend Plan for eligible retirees and beneficiaries are established and amended through the various memoranda of understanding (MOU). The MOU's are agreements established between the City and the respective employee associations. The City does not issue separate stand-alone financial reports for the plans, instead financial information for the trust funds can be obtained by contacting the individual association.

The Water Utility also provides benefits to retirees in the form of an implicit rate subsidy (Implied Subsidy). Under an implied rate subsidy, retirees and current employees are insured together as a group, thus creating a lower rate for retirees than if they were insured separately. Although the retirees are solely responsible for the cost of their health insurance benefits through this plan, the retirees are receiving the benefit of a lower rate.

The contribution requirements of the Water Utility for the Stipend Plan are established and may be amended through the memoranda of understanding (MOU) between the City and the unions. The Water Utility's contribution is financed on a "pay-as-you-go-basis" and the current contribution is unfunded. The contribution requirements of the Water Utility's Implied Subsidy Plan are established by the City Council. The Water Utility is not required by law or contractual agreement to provide funding other than the pay-as-you-go amount necessary to provide current benefits to eligible retirees and beneficiaries.

The Water Utility's annual OPEB cost (expense) for each plan is calculated based on annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal costs each year and amortize any unfunded actuarial liabilities (or funding excess) (UAAL) over a period not to exceed thirty years. The Water Utility's OPEB liability as of June 30, 2008 was \$250.

City-wide information concerning the description of the plans, funding policy and annual OPEB cost, funding status and funding progress, and actuarial methods and assumptions for the year ended June 30, 2008 can be found in the notes to the City's "Comprehensive Annual Financial Report" for the fiscal year ended June 30, 2008.

ARBITRAGE LIABILITY

The Tax Reform Act of 1986 (the Act) requires the Water Utility to calculate and remit rebatable arbitrage earnings to the Internal Revenue Service. Certain debt and interest earnings on the proceeds of the Water Utility are subject to the requirements of the Act which contain yield restrictions on investment of proceeds from tax-exempt financing in higher yielding taxable securities. As of June 30, 2008, no arbitrage liability was due as a result of the advance refunding of the bonds related to the liability. The balance in the arbitrage liability as of June 30, 2007 was \$416.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES *(continued)*

EQUITY

The Water Utility's equity consists of its net assets (assets less liabilities) which are classified into the following three components:

Invested in capital assets, net of related debt – this component consists of capital assets (net of accumulated depreciation) and unamortized debt expenses reduced by the outstanding balance of any bonds or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.

Restricted – this component consists of net assets on which constraints are placed as to their use. Constraints include those imposed by creditors (such as through debt covenants), contributors, or laws or regulation of other governments or constraints imposed by law through constitutional provisions or through enabling legislation.

Unrestricted – this component of net assets consists of net assets that do not meet the definition of “restricted” or “invested in capital assets, net of related debt.”

CONTRIBUTIONS TO THE CITY'S GENERAL FUND

Pursuant to the City Charter, the Water Utility may transfer up to 11.5 percent of its prior year's gross operating revenues to the City's general fund. In fiscal years 2007-08 and 2006-07, the Water Utility transferred 11.5 percent of gross operating revenues, or \$4,955 and \$3,928, respectively.

CASH AND CASH EQUIVALENTS

For the Statements of Cash Flows, cash and cash equivalents include all unrestricted and restricted highly liquid investments with original purchase maturities of three months or less, and all bond construction proceeds available for capital projects. Pooled cash and investments in the City's Treasury represent monies in a cash management pool. Such accounts are similar in nature to demand deposits, and are classified as cash equivalents for the purpose of presentation in the Statements of Cash Flows.

BUDGETS AND BUDGETARY ACCOUNTING

The Water Utility presents, and the City Council adopts, an annual budget. The proposed budget includes estimated expenses and forecasted revenues. The City Council adopts the Water Utility's budget in June each year via resolution.

RECLASSIFICATIONS

Certain reclassifications have been made to prior year's financial statements to conform with the current year's presentation.

PRIOR YEAR DATA

Selected information regarding the prior year have been included in the accompanying financial statements. This information has been included for comparison purposes only and does not represent a complete presentation in accordance with generally accepted accounting principles. Accordingly, such information should be read in conjunction with the government's prior year financial statements, from which this selected financial data was derived.

NOTES TO THE FINANCIAL STATEMENTS: WATER

NOTE 2. CASH AND INVESTMENTS

Cash and investments at June 30, 2008 and 2007, consist of the following (in thousands):

	June 30, 2008	June 30, 2007
	(Fair Value)	
Equity interest in City Treasurer's investment pool	\$ 35,688	\$ 45,343
Investments at fiscal agent	54,260	15,548
	<u>89,948</u>	<u>60,891</u>
Deposits with financial institutions	2,434	2,434
Total cash and investments	<u>\$ 92,382</u>	<u>\$ 63,325</u>

The amounts above are reflected in the accompanying financial statements as:

	June 30, 2008	June 30, 2007
Unrestricted cash and cash equivalents	\$ 29,577	\$ 40,127
Restricted cash and cash equivalents	6,111	5,216
Restricted cash and investments at fiscal agent	56,694	17,982
Total cash and investments	<u>\$ 92,382</u>	<u>\$ 63,325</u>

Cash and investments distribution by maturities as of year end are as follows:

Investment Type	Total	Remaining Maturity (in Months)			
		12 Months or less	13 to 24 Months	25 to 60 Months	More than 60 Months
Held by fiscal agent					
Money market funds	\$ 997	\$ 997	\$ -	\$ -	\$ -
Investment contracts ¹	53,263	-	48,245	-	5,018
City Treasurer's investment pool ²					
Money market funds	840	840	-	-	-
Federal agency securities	23,590	3,502	9,080	11,008	-
Corp medium term notes	2,495	1,488	1,007	-	-
State investment pool	8,763	8,763	-	-	-
Total	<u>\$ 89,948</u>	<u>\$ 15,590</u>	<u>\$ 58,332</u>	<u>\$ 11,008</u>	<u>\$ 5,018</u>

Presented below is the actual ratings as of year end for each investment type:

Investment Type	Total	Rating as of Year End			
		AAA	AA+	AA	Unrated
Held by fiscal agent					
Money market funds	\$ 997	\$ 997	\$ -	\$ -	\$ -
Investment contracts	53,263	-	-	-	53,263
City Treasurer's investment pool ²					
Money market funds	840	693	-	-	147
Federal agency securities	23,590	23,590	-	-	-
Corp medium term notes	2,495	1,007	497	991	-
State investment pool	8,763	-	-	-	8,763
Total	<u>\$ 89,948</u>	<u>\$ 26,287</u>	<u>\$ 497</u>	<u>\$ 991</u>	<u>\$ 62,173</u>

¹Amounts related to bond construction proceeds are invested in specific maturities but are available for construction of capital assets as funding is needed.

²Additional information on investment types and credit risk may be found in the City's "Comprehensive Annual Financial Report."

NOTES TO THE FINANCIAL STATEMENTS: WATER

NOTE 3. UTILITY PLANT

The following is a summary of changes in utility plant during the fiscal years ended June 30, 2008 and 2007 (in thousands):

	Balance, As of 6/30/06	Additions	Retirements/ Transfers	Balance, As of 6/30/07	Additions	Retirements/ Transfers	Balance, As of 6/30/08
Source of supply	\$ 32,684	\$ 138	\$ -	\$ 32,822	\$ 3,058	\$ -	\$ 35,880
Pumping	13,986	67	-	14,053	4,166	-	18,219
Treatment	15,449	7,248	-	22,697	1,075	-	23,772
Transmission and distribution	273,785	10,873	(648)	284,010	27,901	(623)	311,288
General	8,969	1,210	(134)	10,045	2,407	(164)	12,288
Depreciable utility plant	344,873	19,536	(782)	363,627	38,607	(787)	401,447
Less accumulated depreciation:							
Source of supply	(9,957)	(595)	(4)	(10,556)	(610)	5	(11,161)
Pumping	(6,068)	(344)	-	(6,412)	(356)	-	(6,768)
Treatment	(1,966)	(438)	-	(2,404)	(755)	-	(3,159)
Transmission and distribution	(83,077)	(5,819)	443	(88,453)	(6,251)	487	(94,217)
General	(5,903)	(586)	124	(6,365)	(833)	163	(7,035)
Accumulated depreciation	(106,971)	(7,782)	563	(114,190)	(8,805)	655	(122,340)
Net depreciable utility plant	237,902	11,754	(219)	249,437	29,802	(132)	279,107
Land	3,891	35	(3)	3,923	3,759	-	7,682
Intangible	5,969	-	-	5,969	-	-	5,969
Construction in progress	6,663	24,294	(3,890)	27,067	44,888	(40,077)	31,878
Nondepreciable utility plant	16,523	24,329	(3,893)	36,959	48,647	(40,077)	45,529
Total utility plant	\$ 254,425	\$ 36,083	\$ (4,112)	\$ 286,396	\$ 78,449	\$ (40,209)	\$ 324,636

NOTE 4. LONG-TERM OBLIGATIONS

The following is a summary of changes in long-term obligations during the fiscal years ended June 30, 2008 and 2007 (in thousands):

	Balance, As of 6/30/06	Additions	Reductions	Balance, As of 6/30/07	Additions	Reductions	Balance, As of 6/30/08	Due Within One Year
Revenue bonds	\$ 98,432	\$ -	\$ (3,333)	\$ 95,099	\$ 117,527	\$ (61,716)	\$ 150,910	\$ 4,375
Pension obligation	5,823	-	(62)	5,761	-	(79)	5,682	98
Postemployment benefits payable	-	-	-	-	250	-	250	121
Water stock acquisition rights	979	-	(5)	974	-	(10)	964	150
Arbitrage liability	-	416	-	416	9	(425)	-	-
Total long-term obligations	\$ 105,234	\$ 416	\$ (3,400)	\$ 102,250	\$ 117,786	\$ (62,230)	\$ 157,806	\$ 4,744

NOTES TO THE FINANCIAL STATEMENTS: WATER

NOTE 4. LONG-TERM OBLIGATIONS *(continued)*

Long-term debt consists of the following (in thousands):

Contracts Payable

	June 30, 2008	June 30, 2007
Water Stock Acquisitions: Payable on demand to various water companies	\$ 964	\$ 974
Total contracts payable	<u>964</u>	<u>974</u>

Revenue Bonds Payable

\$69,840 1991 Water Revenue Bonds: \$25,900 serial capital appreciation bonds due in annual installments from \$3,235 to \$3,240 through October 1, 2010 (partially advance refunded in 1998)	9,710	12,950
\$30,965 1998 Water Refunding/Revenue Bonds: \$15,055 serial bonds due in annual installments from \$300 to \$3,690 through October 1, 2013, interest from 4.63 percent to 5.38 percent; \$10,155 term bonds due October 1, 2018, interest at 5.0 percent; \$5,755 term bonds due October 1, 2027 (partially advance refunded in 2005)	20,705	20,990
\$20,000 2001 Water Revenue Bonds: \$10,070 serial bonds due in annual installments from \$415 to \$585 through October 1, 2016, interest from 3.63 percent to 4.75 percent; \$4,345 term bonds due October 1, 2026 and \$5,585 term bonds due October 1, 2031 were advance refunded in 2005	4,445	4,850
\$61,125 2005 Water Refunding/Revenue Bonds: All outstanding Auction Rate Securities were advance refunded on May 7, 2008 with 2008 Water Refunding/Revenue bonds	-	60,725
\$60,300 2008 Water Refunding/Revenue Series A Bonds: \$60,300 variable rate bonds due in annual installments from \$425 to \$3,950 from October 1, 2008 through October 1, 2035. Interest rate is subject to weekly repricing (rate at June 26, 2008 was 3.4 percent)	60,300	-
\$58,235 2008 Water Revenue Series B Bonds: \$19,890 serial bonds due in annual installments from \$1,210 to \$2,585 from October 1, 2016 through October 1, 2028, interest from 4.0 percent to 5.0 percent; \$11,810 term bonds due October 1, 2033, interest at 5.0 percent; \$26,535 term bonds due October 1, 2038, interest at 5.0 percent	58,235	-
Total water revenue bonds payable	<u>153,395</u>	<u>99,515</u>
Total water revenue bonds and contracts payable	154,359	100,489
Unamortized deferred bond refunding costs	(3,198)	(2,510)
Unamortized capital appreciation	(938)	(1,629)
Unamortized bond premium (discount)	<u>1,651</u>	<u>(277)</u>
Total water revenue bonds and contracts payable, net of deferred bond refunding costs, capital appreciation, and bond premium/discount	151,874	96,073
Less current portion	<u>(4,525)</u>	<u>(4,505)</u>
Total long-term water revenue bonds and contracts payable	<u>\$ 147,349</u>	<u>\$ 91,568</u>

Annual debt service requirements to maturity, as of June 30, 2008, are as follows (in thousands):

	2009	2010	2011	2012	2013	2014-2018	2019-2023	2024-2028	2029-2033	2034-2038	2039-2043	Total
Principal	\$ 4,525	\$ 4,565	\$ 4,615	\$ 4,740	\$ 4,970	\$ 22,654	\$ 18,600	\$ 22,310	\$ 27,000	\$ 32,875	\$ 7,505	\$ 154,359
Interest	5,534	5,939	5,892	5,939	5,709	24,203	20,371	16,550	11,744	5,712	188	107,781
Total	\$ 10,059	\$ 10,504	\$ 10,507	\$ 10,679	\$ 10,679	\$ 46,857	\$ 38,971	\$ 38,860	\$ 38,744	\$ 38,587	\$ 7,693	\$ 262,140

NOTE 4. LONG-TERM OBLIGATIONS *(continued)*

PRIOR YEAR DEFEASANCE OF DEBT

In prior years the Water Utility defeased certain Revenue Bonds by placing the proceeds of the new bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the Water Utility's financial statements. At fiscal year ended June 30, 2008, \$21,025 of bonds outstanding are considered defeased.

2008 WATER REFUNDING/REVENUE BONDS

The City entered into a refunding transaction during the fiscal year in response to unusual market conditions brought about by the downgrade of several of the leading municipal bond insurers. These companies provided insurance for the City's Auction Rate Securities ("ARS"). The market that routinely absorbed these instruments through a weekly auction process discontinued their interest in the product and the result was excessively high interest rates, often to the default rate (defined in the bond documents) as the auction "failed," having insufficient bids to clear the auction.

The City's ARS debt was layered with "synthetic fixed rate" swaps designed to maintain the overall cost of funds at a level considered to be in the City's best interest. The unusual market conditions resulted in the swaps not performing as intended and thus the ARS debt was refunded with Variable Rate Demand Notes ("VRDNs"). The transaction was completed (as described below), and the variable rates received on the VRDNs as of June 30, 2008 have resulted in the swaps again functioning as intended, to control the cost of funds on the outstanding variable rate debt.

Because one variable rate debt product was exchanged for another, the typical refunding disclosure measuring the difference in aggregate debt service and calculating an economic gain or loss is less relevant, as the future cash flows of each leg of the calculation are uncertain. For this reason, only the terms of the transaction are described.

On May 7, 2008, \$60,300 of Water Refunding/Revenue Series A Bonds were sold with a true interest cost of 3.22% to refund \$60,300 of previously outstanding 2005 Water Refunding/Revenue Bonds. The refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of \$2,905. The difference is being charged to operations using the proportional method. The City completed the refunding to eliminate its investment in auction rate securities.

On May 15, 2008, the Water Utility also issued \$58,235 of Water Revenue Series B Bonds to finance additional capital projects of the City's Capital Improvement Program of the Water System. Series B is comprised of: \$19,890 serial bonds, with principal payments from October 1, 2016 through October 1, 2028 ranging from \$1,210 to \$2,585 at interest rates between 4.0 percent and 5.0 percent; \$11,810 term bonds, maturing on October 1, 2033 with interest rate at 5.0 percent; \$26,535 term bonds, maturing on October 1, 2038 with interest rate at 5.0 percent.

INTEREST RATE SWAPS ON REVENUE BONDS

Objective: As a means to lower borrowing costs, when compared against fixed-rate bonds at the time of issuance in May 2008, the City entered into interest rate swap agreements in connection with its \$60,300 2008 Water Refunding/Revenue Series A Bonds. The intention of the swap was to effectively change the City's variable interest rate on the bonds to a synthetic fixed rate of 3.20%.

Terms: Under the swaps, the City pays the counterparty a fixed payment as noted above and receives a variable payment computed as 62.68% of the London Interbank Offering Rate ("LIBOR") one month index plus 12 basis points. The swaps have notional amounts equal to the principal amounts stated above. Starting in fiscal year 2009, the notional value of the swaps and the principal amounts of the associated debt decline by \$425 to \$3,950 until the debt is completely retired in fiscal year 2036.

NOTE 4. LONG-TERM OBLIGATIONS *(continued)*

The bonds and the related swap agreements for the 2008 Water Refunding/Revenue Series A Bonds mature on October 1, 2035. As of June 30, 2008, rates were as follows:

Interest rate swap:	Terms	Rates
Fixed payment to counterparty	Fixed	3.20000%
Variable payment from counterparty	62.68 LIBOR + 12bps	(3.05273%)
Net interest rate swap payments		0.14727%
Variable-rate bond coupon payments		3.32190%
Synthetic interest on bonds		3.46917%

Fair value: As of June 30, 2008, in connection with all swap agreements, the transactions had a total negative fair value of \$(468). Because the coupons on the City’s variable-rate bonds adjust to changing interest rates, the bonds do not have a corresponding fair value decrease. The fair value was developed by a pricing service using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement of the swap.

Credit risk: As of June 30, 2008, the City was not exposed to credit risk because the swap had a negative fair value. The swap counterparty, Bear Stearns/J.P. Morgan was rated AA- by Standard & Poor’s. To mitigate the potential for credit risk, the swap agreements require the fair value of the swap will be collateralized by the counterparty with U.S. Government securities if the counterparty’s rating decreases to negotiated trigger points. Collateral would be posted with a third-party custodian. At June 30, 2008, there is no requirement for collateral posting for any of the outstanding swaps.

Basis risk: As noted above, the swaps expose the City to basis risk should the relationship between LIBOR and the auction-rate converge, changing the synthetic rate on the bonds. If a change occurs that results in the rates moving to convergence, the expected cost savings may not be realized.

Termination risk: The derivative contract uses the International Swap Dealers Association Master Agreement, which includes standard termination events, such as failure to pay and bankruptcy. The Schedule to the Master Agreement includes an “additional termination event.” That is, a swap may be terminated by the City if the counterparty’s credit quality falls below “BBB-” as issued by Standards & Poor’s. The City or the counterparty may terminate a swap if the other party fails to perform under the terms of the contract. If a swap is terminated, the variable-rate bond would no longer carry a synthetic interest rate. Also, if at the time of termination a swap has a negative fair value, the City would be liable to the counterparty for a payment equal to the swap’s fair value.

NOTES TO THE FINANCIAL STATEMENTS: WATER

NOTE 4. LONG-TERM OBLIGATIONS *(continued)*

Swap payments and associated debt: As of June 30, 2008, the debt service requirements of the variable-rate debt and net swap payments, assuming current interest rates remain the same for their term, are summarized as follows. As rates vary, variable-rate bond interest payments and net swap payments will vary.

<u>Variable-Rate Bonds</u>						
Fiscal Year Ending June 30,	Principal	Interest	Interest Rate Swaps, Net	Total		
2009	\$ 425	\$ 1,989	\$ 88	\$	2,502	
2010	425	1,975	88		2,488	
2011	450	1,960	87		2,497	
2012	800	1,933	86		2,819	
2013	825	1,906	85		2,816	
2014-2018	4,950	9,084	403		14,437	
2019-2023	11,450	7,646	339		19,435	
2024-2028	14,525	5,390	239		20,154	
2029-2033	14,975	2,907	129		18,011	
2034-2038	11,475	389	17		11,881	
Total	\$ 60,300	\$ 35,179	\$ 1,561	\$	97,040	

NOTE 5. RESTRICTED EQUITY

Pursuant to applicable bond indentures, a reserve for debt service has been established by restricting assets and reserving a portion of equity. Bond indentures for Riverside's water revenue bonds require reserves that equate to the maximum annual debt service required in future years plus three months interest and nine months principal due in the next fiscal year. The 2008 Refunding/Revenue Series A Bonds require 110% of the monthly accrued interest be included in the reserve. Additional reserves for the 2008 Revenue Series B Bonds and the 1998 Revenue Bonds are not required due to the purchase of surety bonds to cover the reserve requirements.

NOTE 6. LITIGATION

The Water Utility is a defendant in various lawsuits arising in the normal course of business. Present lawsuits and other claims against the Water Utility are incidental to the ordinary course of operations of the Water Utility and are largely covered by the City's self-insurance program. In the opinion of management and the City Attorney, such claims and litigation will not have a materially adverse effect upon the financial position or results of operation of the Water Utility.

The Water Utility is also a plaintiff in a lawsuit against the manufacturers and distributors of methyl tertiary-butyl ether (MTBE) and its by-products, and of fuel containing these chemicals, arising out of the threat to the Water Utility wells of contamination with those chemicals from leaking underground storage tanks.

The defendants removed this lawsuit to federal court and then transferred the case to the Judicial Panel on Multidistrict Litigation, New York, where it was consolidated with all other pending MTBE water contamination litigation cases in the country. Although the City has tentatively settled with a number of the defendants, the settlement has not been approved by the court and there is no trial date for the remainder of the case.

NOTE 6. LITIGATION *(continued)*

The City also detected perchlorate in a number of its drinking water wells. While Lockheed Martin has not admitted liability for the presence of perchlorate in the City's wells, Lockheed Martin has agreed to pay for the design, construction, installation, rental and permitting, and to reimburse the City for its operational and maintenance costs associated with perchlorate treatment facilities on certain of the City's drinking water wells, under an agreement between the City and Lockheed Martin dated October 29, 2002 (the "Interim Perchlorate Agreement"). The Interim Perchlorate Agreement has been thrice amended, on November 25, 2003, on February 22, 2005, and on May 31, 2007, with each amendment increasing the number of wells from an original four wells to fourteen wells being treated for perchlorate at Lockheed Martin's expense.

NOTE 7. CONSTRUCTION COMMITMENTS

As of June 30, 2008, the Water Utility had major commitments of approximately \$5,520 with respect to unfinished capital projects, of which \$2,943 is expected to be funded by bonds, \$1,740 funded by other sources and \$837 funded by rates.

KEY HISTORICAL OPERATING DATA: WATER

WATER SUPPLY *(acre feet)*

	2007/08	2006/07	2005/06	2004/05	2003/04
Pumping	80,974	85,299	76,605	73,732	81,797
Purchases	1,643	2,092	2,670	4,137	1,693
Total:	82,617	87,391	79,275	77,869	83,490
Percentage pumped	98.0%	97.6%	96.6%	94.7%	98.0%
System peak day (gallons)	111,300,000	109,200,000	118,782,000	112,094,000	105,029,000

WATER USE

	2007/08	2006/07	2005/06	2004/05	2003/04
Number of meters as of year end					
Residential	57,694	57,666	57,308	56,916	56,254
Commercial/Industrial	5,446	5,279	5,204	5,114	4,932
Other	354	486	473	462	482
Total:	63,494	63,431	62,985	62,492	61,668
*CCF sales					
Residential	18,483,522	19,848,653	17,702,717	17,245,315	19,056,556
Commercial/Industrial	10,510,953	10,817,783	9,822,196	9,252,639	9,988,578
Other	970,239	1,243,927	1,157,130	1,199,448	1,361,809
Wholesale	618,552	199,845	182,987	177,851	189,377
Total:	30,583,266	32,110,208	28,865,030	27,875,253	30,596,320

*(CCF equals 100 cubic feet)

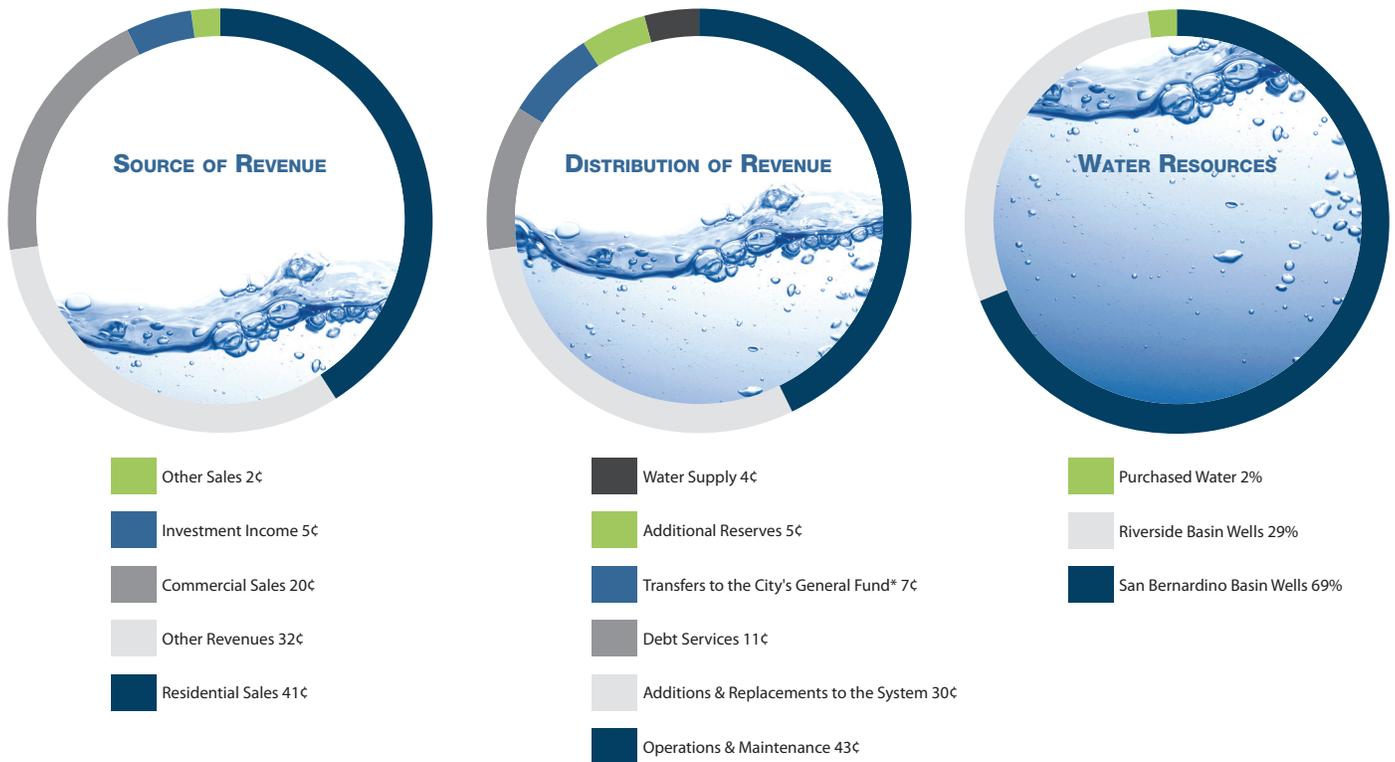
WATER FACTS

	2007/08	2006/07	2005/06	2004/05	2003/04
Average annual CCF per residential customer	320	345	312	308	342
Average price (\$/CCF) per residential customer	\$1.63	\$1.43	\$1.26	\$1.16	\$1.05
Debt service coverage ratio	3.88	3.38	5.11	2.85	3.52
Employees ¹	167	165	137	130	130

¹Approved positions

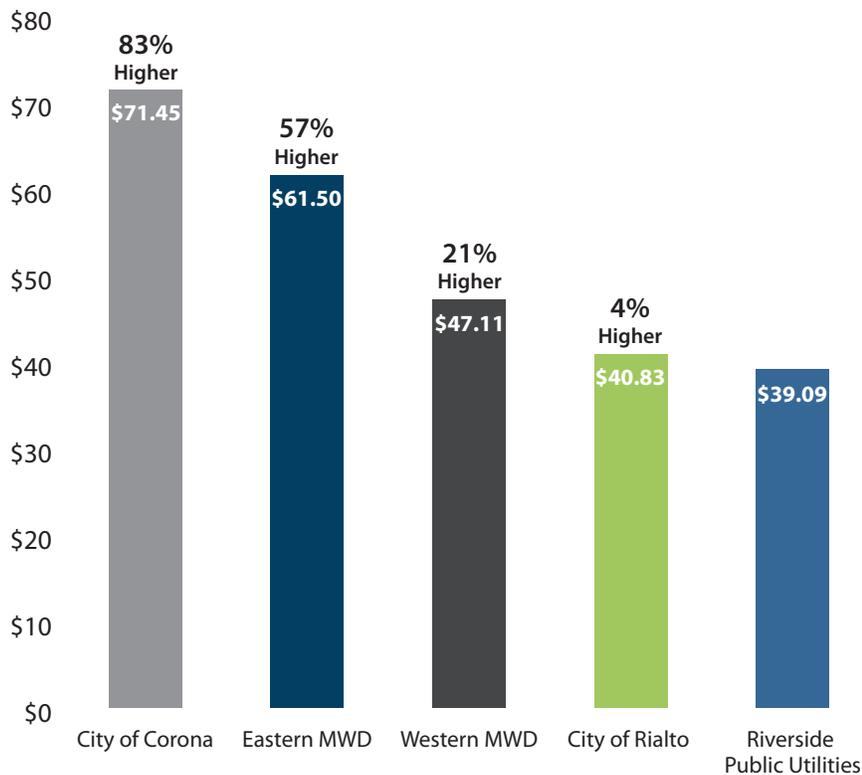
KEY HISTORICAL OPERATING DATA: WATER

2007/2008 WATER REVENUE AND RESOURCES



* BASED ON TRANSFER OF 11.5% OF FISCAL YEAR 2006/2007 REVENUES.

RESIDENTIAL WATER RATE COMPARISON – 27 CCF PER MONTH (AS OF JULY 1, 2008)

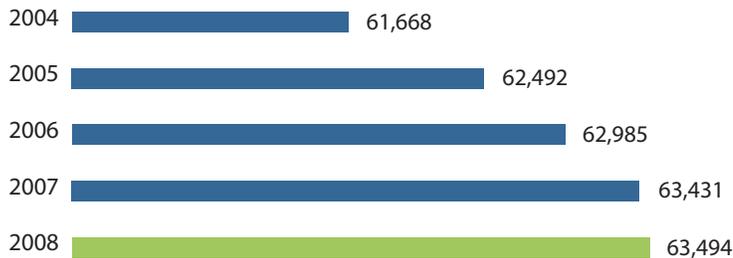


KEY HISTORICAL OPERATING DATA: WATER

GENERAL FUND TRANSFER *(in millions)*



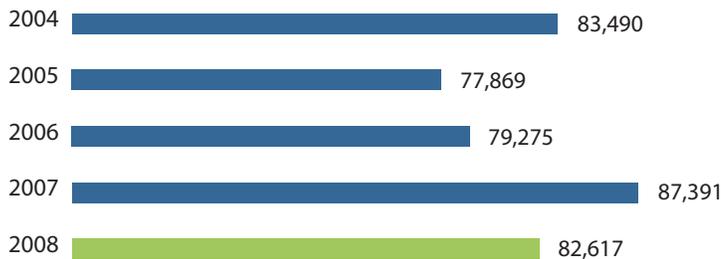
NUMBER OF METERS AT YEAR END



TOTAL OPERATING REVENUE *(in millions)*



PRODUCTION *(in acre feet)*



PEAK DAY DEMAND *(in million gallons)*



WATER FACTS AND SYSTEM DATA

Established	1913
Service Area Population	296,842
Service Area Size (square miles)	75.2
System Data:	
Smallest pipeline	2.0"
Largest pipeline	72.0"
Miles of pipeline	988
Number of domestic wells	51
Number of active reservoirs	15
Total reservoir capacity (gallons)	99,990,000
Number of treatment plants	7
Number of treatment vessels	104
Miles of canal	14
Number of fire hydrants	7,381
Daily average production (gallons)	73,849,248
2007-2008 Peak day (gallons):	111,300,000
7/2/07, 103 degrees	
Historical peak (gallons):	118,782,000
8/9/05, 99 degrees	

BOND RATINGS

FITCH RATINGS	AA
STANDARD & POOR'S	AA+