Water 2011

WWW.MOSSADAMS.COM

MOSS ADAMS LLP
Certified Public Accountants | Business Consultants

REPORT OF INDEPENDENT AUDITORS

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

We have audited the accompanying balance sheet of the City of Riverside, California, Water Utility (Water Utility), as of and for the year ended June 30, 2011, and the related statement of revenues, expenses and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the Water Utility's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. 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 includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. 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 audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Water Utility and do not purport to, and do not, present fairly the financial position of City of Riverside, as of June 30, 2011, and the changes in its financial position, or, where applicable, its cash flows for the year then ended 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 Water Utility as of June 30, 2011 and the results of its individual and combined operations and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis preceding the financial statements is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. 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.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The financial information included as supplementary information following the financial statements and notes to financial statements is provided for purposes 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 audit of the financial statements and we do not express an opinion on it.

Praxity MEMBER
GLOBAL ALLIANCE OF INDEPENDENT FIRMS

Independent Auditors' Report: Water

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

The financial statements of the City of Riverside, California, Water Utility, as of June 30, 2010, were audited by other auditors, whose report dated October 18, 2010, expressed an unqualified opinion on those statements.

Moss Adams LLP

Los Angeles, California
October 14, 2011

Independent Auditors' Report: Water

Management's Discussion and Analysis: Water

As management of Riverside Public Utilities, a department of the City of Riverside (the City), we offer the readers this narrative overview and analysis of the 2010-11 financial report for the period ended June 30, 2011 and 2010 for Riverside's Water Utility (the Utility), an enterprise fund of the City. We encourage readers to consider the information presented here in conjunction with additional information furnished in our financial statements, which begin on page 74 of this report. All amounts, unless otherwise indicated, are expressed in thousands of dollars.

FINANCIAL HIGHLIGHTS

Fiscal years 2011 and 2010 reflected strong operating results for the Water Utility, with retail sales exceeding the previous year's results, primarily from the effects of rate increases and an expanded customer base, offset by a decrease in consumption.

- Retail sales, net of reserve/recovery were $55,186 and $51,147 for the years ended June 30, 2011 and 2010, respectively. The increase in sales was primarily due to the final year of rate increases under the SAFE W.A.T.E.R (Water Available to Everyone in Riverside) Plan required to support the Utility's Water Master, Water Supply and Asset Management Plans, offset by a 3% reduction in retail consumption.
- The assets of the Utility exceeded its liabilities (equity) at the close of fiscal years 2011 and 2010 by $301,733 and $277,994, respectively. Of this amount, $52,181 and $32,029, respectively, may be used to meet the Utility's ongoing obligations to creditors and customers.
- The Utility's total equity as of June 30, 2011 and 2010 increased by $23,739 and $2,851 from fiscal years ended June 30, 2010 and 2009, respectively, primarily due to the intra-entity property sale and positive operating results.
- As of June 30, 2011 and 2010, unrestricted equity represented over 110% and 68% 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 are comprised of 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 with 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 described in more detail in the accompanying Notes to the Financial Statements.

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 80 to 92 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 $301,733 and $277,994 at the close of the fiscal years 2011 and 2010, respectively.

The following table summarizes the Utility's financial condition as of June 30, 2011, 2010 and 2009:

CONDENSED STATEMENTS OF EQUITY (NET ASSETS)

	2011	2010	2009
Current and other assets	$ 143,395	$ 148,966	$ 85,935
Capital assets	392,264	372,792	356,089
Total assets	535,659	521,758	442,024
Long-term debt outstanding	209,112	219,414	142,972
Other liabilities	24,814	24,350	23,909
Total liabilities	233,926	243,764	166,881
Invested in capital assets, net of related debt	241,552	237,366	237,738
Restricted	8,000	8,599	7,044
Unrestricted	52,181	32,029	30,361
Total equity (net assets)	$ 301,733	$ 277,994	$ 275,143

ASSETS

Fiscal Year 2011 Total assets of $535,659 reflect an increase of $13,901 (2.7%), mainly due to the following:

- Current and other assets, comprised of restricted and unrestricted assets, reflect a cash and cash equivalent increase of $27,434 primarily due to the intra-entity property sale (Note 8) and positive operating results, offset by the use of $25,620 of bond proceeds for capital projects and a decrease of $6,580 in deferred debits on an interest rate swap fair valuation as a result of the implementation of Governmental Accounting Standards Board Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments* (GASB 53). See Notes 1 and 4 in the accompanying financial statements for additional information.
- Net capital assets (Utility plant net of depreciation), increased by $19,472 primarily due to an increase of $11,145 in completed transmission and distribution system assets and an increase of $9,446 in construction in progress related to the pipeline replacement program, system expansion and improvements, facilities rehabilitation and reservoir construction. Additional capital asset information can be found in the "Capital Assets and Debt Administration" section of the financial analysis.

Fiscal Year 2010 Total assets of $521,758 reflect an increase of $79,734 (18.0%), due to an increase in current and other assets of $63,031 primarily due to the issuance of the 2009 Water Refunding/Revenue Series A and B Bonds, offset by the use of $19,969 of bonds proceeds for capital projects and an increase of $2,865 in deferred debits on an interest rate swap fair valuation as a result of the implementation of GASB 53. Net capital assets (Utility plant) increased by $16,703 as a result of significant investment in the pipeline replacement program, system expansion and improvements, and construction of treatment facilities.

UTILITY FINANCIAL ANALYSIS (CONTINUED)

LIABILITIES

Fiscal Year 2011 The Utility's total liabilities were $233,926, a decrease of $9,838 (4.0%), mainly due to the following:

- Long-term debt outstanding decreased by $10,302 primarily due to $4,660 in principal payments and $5,675 increase in unamortized deferred bond refunding costs.

Fiscal Year 2010 The Utility's total liabilities were $243,764, an increase of $76,883 (46.1%), primarily due to long-term debt outstanding increased by $76,442 due to the issuance of the 2009 Water Refunding/Revenue Series A and B Bonds, offset by $4,415 in principal payments and advance refundings of $21,765. Other liabilities increased by $441 primarily due to a $2,865 increase in the fair value of swap derivatives, offset by a $2,602 decrease in payables.

EQUITY (NET ASSETS)

Fiscal Year 2011 The Utility's equity, which represents the difference between the Utility's resources and its obligations, totaled $301,733, an increase of $23,739 (8.5%) is comprised of the following:

- The largest portion of the Utility's equity is $241,552 (80.0%), 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 $4,186 (1.8%) primarily due to an increase in capital assets constructed or purchased during the fiscal year, net of the debt used to acquire these assets. Additional capital asset information can be found in the "Capital Assets and Debt Administration" section.
- The restricted portion totaled $8,000 (2.7% 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 Conservation and Reclamation Programs. This portion decreased by $599 from prior fiscal year primarily due to decreases in debt service reserves for principal and interest payments for bond issues.
- The unrestricted portion totaled $52,181 (17.3% of total equity), an increase of $20,152, was primarily attributable to the intra-entity property sale (Note 8) and positive operating results.

Fiscal Year 2010 The Utility's equity increased by $2,851 (1.0%) to $277,994. The largest portion of the equity, $237,366 (85.4%), is represented by investment in capital assets, which decreased slightly by $372 (less than 1.0%) primarily due to an increase in capital assets constructed or purchased during the fiscal year, net of the debt used to acquire these assets, offset by depreciation expense. The restricted portion increased by $1,555 due to increases in debt service reserves for principal and interest payments for new bond issues. The unrestricted portion increased by $1,668, primarily attributable to positive operating results.

UTILITY FINANCIAL ANALYSIS (CONTINUED)

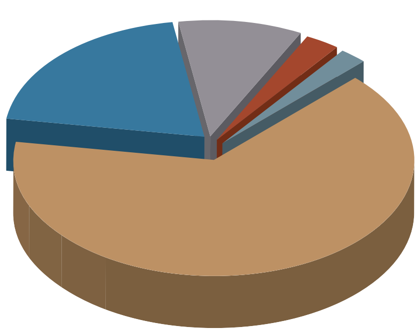
The Water Utility's overall increase in equity of $23,739 and $2,851 during fiscal years 2011 and 2010, respectively, was due to the intra-entity property sale and positive operating results that can be further explained in the following Condensed Statements of Changes in Equity:

CONDENSED STATEMENTS OF CHANGES IN EQUITY (NET ASSETS)

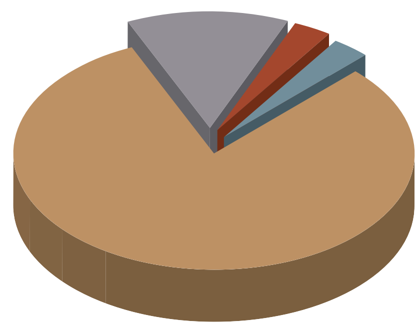
	2011	2010	2009
Revenues:			
Retail sales, net	$ 55,186	$ 51,147	$ 49,591
Other revenues	8,936	8,553	5,311
Investment income	2,635	1,815	3,169
Capital contributions	1,982	2,052	7,148
Total revenues	68,739	63,567	65,219
Expenses:			
Operations and maintenance	31,411	32,151	31,501
Purchased energy	4,558	4,362	4,578
Depreciation	11,386	10,660	9,771
Interest expenses and fiscal charges	8,912	7,886	7,049
Total expenses	56,267	55,059	52,899
Transfers to the City's general fund	(5,847)	(5,657)	(5,276)
Special item	17,114	-	(6,388)
Changes in equity	23,739	2,851	656
Equity, July 1	277,994	275,143	274,487
Equity, June 30	$ 301,733	$ 277,994	$ 275,143

REVENUES BY SOURCES

June 30, 2011



June 30, 2010



UTILITY FINANCIAL ANALYSIS (CONTINUED)

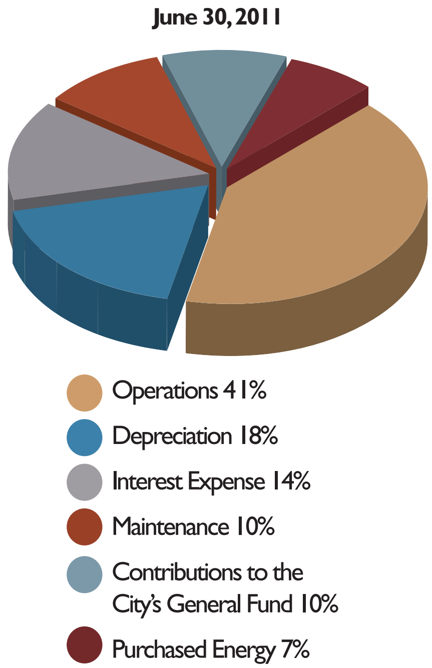
Fiscal Year 2011 Total revenues of $85,853, which includes special item, increased by $22,286 (35.1%) from prior fiscal year, due to the following major changes:

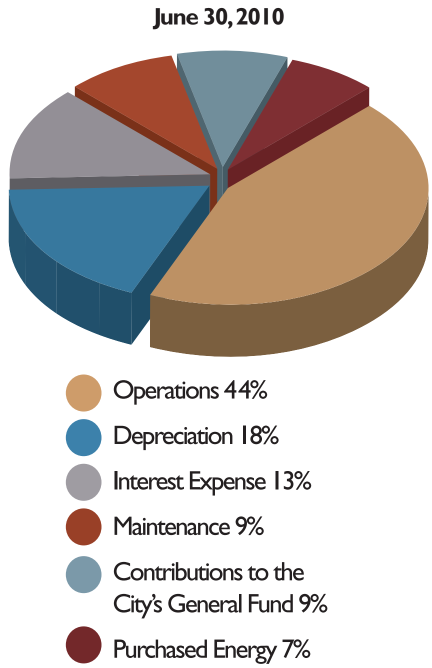
- Retail sales (residential, commercial, industrial, and other sales), net of reserve/recovery, totaled $55,186, an increase of $4,039 (7.9%) over the prior fiscal year. Retail sales continue to be the primary revenue source for the Water Utility, making up 65% of total revenues. The increase in sales was primarily due to a 10% rate increase that became effective November 1, 2010 as part of the SAFE W.A.T.E.R. Plan, offset by a 3% decrease in retail consumption.
- Special item of $17,114 represents an intra-entity property sale (Note 8).
- Investment income of $2,635 increased by $820 (45.2%) primarily due to interest earned on the increase in cash as a result of the intra-entity property sale (Note 8) and a full year's interest on bond proceeds.

Fiscal Year 2010 Total revenues of $63,567 decreased by $1,652 (2.5%) from prior fiscal year due to the following major changes:

- Net retail sales were $51,147, 80.5% of total revenues, reflecting an increase of $1,556 (3.1%) in net retail sales from the prior fiscal year primarily due to a 10.0% rate increase that became effective November 1, 2009 as part of the SAFE W.A.T.E.R. Plan, offset by a 9.2% decrease in retail consumption.
- Other revenues of $8,553 increased by $3,242 (61.0%) predominantly due to a $963 increase in wholesale sales attributed to the Western Municipal Water Wheeling agreement and an increased gain on sale of land in the amount of $1,801.
- Investment income of $1,815 reflects a decrease of $1,354 (42.7%), due to an overall decrease of $640 in the fair market value and interest from investments and a decrease of $714 on interest earned on bond construction cash.
- Capital contributions were $2,052 and reflect a decrease of $5,096 (71.3%), primarily due to a decrease of $2,187 in contributions from State grants for reimbursable capital project costs, decreases of $2,656 in non-cash developer contributions, and $267 from developers for construction projects due to the slowdown in development related activities.

EXPENSES BY SOURCES





UTILITY FINANCIAL ANALYSIS (CONTINUED)

Fiscal Year 2011 Total expenses, excluding general fund transfer, were $56,267, an increase of $1,208 (2.2%), due to the items discussed below:

- Interest expense and fiscal charges were $8,912, and reflect an increase of $1,026 (13%), due to interest costs associated with the 2011 bond issuance and a full year of interest for the 2009 bond issuance issued December 2009.
- Depreciation expense of $11,386 increased $726 (6.8%) primarily due to the completion of $20,622 of capital projects that were included as depreciable capital assets.

Fiscal Year 2010 Total expenses were $55,059, reflecting an increase of $2,160 (4.1%), due to an increase in personnel-related expenses, offset by a decrease in general operating expenses mainly due to over-pumping of entitlements in previous years which were recorded in fiscal year 2009. Overall purchased energy costs were consistent with prior year. Interest expense and fiscal charges increased due to increased interest costs associated with the 2009 bond issues and depreciation expense increased due to the completion of $36,416 of capital projects that were included as depreciable capital assets.

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 of Riverside 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 2011 The Water Utility transferred the maximum allowable by the City Charter to the City's general fund, or $5,847, an increase of $190, primarily the result of a $1,556 increase in retail sales for fiscal year 2010.

Fiscal Year 2010 Transfers to the City's general fund of $5,657 increased by $381, primarily the result of increased retail sales of $3,427 for fiscal year 2009.

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, land, intangibles, 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 accumulated depreciation at June 30:

	2011	2010	2009
Source of supply	$ 49,454	$ 49,708	$ 49,485
Pumping	17,175	16,884	13,534
Treatment	18,499	19,246	19,843
Transmission and distribution	260,141	248,996	226,454
General	5,259	5,720	5,542
Land	10,861	10,809	10,809
Intangible	6,307	6,307	6,015
Construction in progress	24,568	15,122	24,407
Total	$ 392,264	$ 372,792	$ 356,089

Fiscal Year 2011 The Utility's investment in capital assets was $392,264, an increase of $19,472 (5.2%). The increase (net of accumulated depreciation) resulted mainly from the following significant capital projects:

- $22,101 for system expansion and improvements, facilities rehabilitation and reservoir construction.
- $6,299 for continued pipeline replacement programs.

CAPITAL ASSETS AND DEBT ADMINISTRATION (CONTINUED)

Fiscal Year 2010 Investment in capital assets (net of accumulated depreciation) for the Utility increased by $16,703 (4.7%), for a total of $372,792. Major capital projects included $19,221 for system expansion and improvements including pump station replacements, reservoir construction and facilities rehabilitation, $5,074 for continued pipeline replacement programs and $442 for completion of the John W. North Treatment facility.

Additional information regarding capital assets can be found in Note 3 on Page 88 of this report.

DEBT ADMINISTRATION

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

	2011	2010	2009
Revenue bonds	$ 217,865	$ 222,525	$ 149,020
Contracts payable	947	949	949
Less:			
Current portion	(4,695)	(4,810)	(4,565)
Unamortized deferred bond refunding costs	(9,802)	(4,127)	(3,651)
Unamortized capital appreciation	-	(110)	(427)
Unamortized bond premium (discount)	4,797	4,987	1,646
Total	$ 209,112	$ 219,414	$ 142,972

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 3.49, 2.08, and 2.25 at June 30, 2011, 2010, and 2009, respectively. The debt is backed by the revenues of the Utility (revenue bonds).

Fiscal Year 2011 Total long-term debt decreased by $10,302 (4.7%) to $209,112 primarily due to $4,660 of principal payments and $5,675 increase in unamortized deferred bond refunding costs.

Fiscal Year 2010 Long-term debt of $219,414 increased by $76,442 (53.5%) primarily due to the issuance of the 2009 Water Refunding/Revenue Series A (Tax-exempt Bonds) and B (Federally-taxable Build America Bonds) bond proceeds in the amount of $99,685 issued on December 22, 2009, offset by $4,415 of principal payments and advance refundings of $20,090 for all of the 1998 Water Refunding/Revenue Bonds and $1,675 of the outstanding 2001 Water Revenue Bonds.

Additional information on the Water Utility's long-term debt can be found in Note 4 on pages 88 to 91 of this report.

CREDIT RATINGS

In May 2011, Standard & Poor's upgraded the long-term credit rating on the Water Utility's outstanding debt to a "AAA" from a "AA+" and assigned its highest "A-1+" short-term rating on the 2011A Variable Rate Water Refunding Revenue Bonds. The ratings reflect the Utility's "strong financial performance and metrics including past and projected debt service coverage and ample cash reserves; advantageous water supply position with low-cost groundwater sources providing nearly all of the City's water, thereby helping the Utility to maintain low rates to its customers; and local economic base that is enduring the economic downturn."

In May 2011, Fitch Ratings assigned an "AA+" long-term rating on the 2011A Variable Rate Water Refunding Revenue Bonds and affirmed the "AA+" rating on the Utility's outstanding debt. The ratings reflect the Utility's "healthy debt service coverage and liquidity levels, minimal reliance on connection fee revenues, rate flexibility is strong and competitive rates, capital plan that is designed to increase system reliability and water system that provides an essential service with a low cost of supplies."

In May 2011, Moody's assigned an "Aa2" long-term rating on the 2011A Variable Rate Water Refunding Revenue Bonds and affirmed the "Aa2" rating on the Utility's outstanding debt. The ratings reflect the Utility's "consistent rate increases that have helped drive sound current and projected fiscal operations, water source independence which should insulate the Utility from the vulnerabilities of the State's water supply, and solid debt service coverage levels."

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 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 was 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. The Utility continues to make significant progress in replacing its aging infrastructure and since implementation of the rate increases, the Utility has invested approximately $134 million in infrastructure improvements over the five year period.

The Utility is impacted by the ongoing economic decline affecting virtually all industries in the United States, with retail consumption decreasing 3.0% and 9.2% in fiscal years 2011 and 2010, respectively, over the previous year levels. The water revenues are dependent on weather conditions, with significant wet weather years impacting revenue as residents reduce water used for outdoor landscaping.

Although the Utility is water independent and does not rely on state projects for water supply, under certain emergency conditions or a prolonged interruption of water supply, the challenges faced at the state level could impact the Utility. The state's primary water system, the Sacramento-San Joaquin River Delta, is in an ecological crisis that has led to historic restrictions on water deliveries from northern to southern California and threatens California's economy and endangered species. The levees that protect the Delta are at risk of failure and climate change will exacerbate the existing water management challenges.

In November 2009, the California legislature enacted a comprehensive set of laws aimed at improving the state's water supply reliability and restoring the Sacramento-San Joaquin River Delta ecosystem. The package included four policy bills and an $11.14 billion general obligation bond measure now targeted for the November 2012 ballot. One of the bills enacted, SBX7 7, established a statewide water conservation program that requires a 20% reduction in urban per-capita water use by 2020. It also requires development of agricultural water management plans by December 31, 2012.

The Utility has developed a comprehensive Water Efficiency Master Plan that outlines the steps necessary to comply with the 20% per capita reduction requirement. Significant conservation of resources by our consumers could negatively impact revenues and water rates. Management monitors water sales, revenue and expenses and ensures that ongoing adjustments to budgets are made to keep expenses in line with revenues. For more information on the Utility's conservation efforts and available programs, visit BlueRiverside.com

With completion of the John W. North Water Treatment Plant, the Utility is water independent and does not expect any increased costs to its customers due to the curtailment of water deliveries to Southern California. This new plant created a new source of supply and the Utility has executed an agreement with another local water supplier which is expected to produce additional revenues of $1.8 to $2.0 million per year.

In August 2011, the United States Fish and Wildlife Service (FWS) issued a draft rule designating portions of the Santa Ana River as critical habitat for the Southwestern Willow Flycatcher *(Empidonax traillii extimus)*, a federally threatened bird species. If approved, this could increase costs to planned water supply projects.

In December 2010, the FWS issued a final rule designating the Santa Ana River and the San Gabriel River as critical habitat for the Santa Ana Sucker *(Catostomus santaanae)*, a federally threatened fish species. This final rule expanded the existing designation of 8,305 acres to 9,331 acres of the Santa Ana River and the San Gabriel River as critical habitat for the Santa Ana Sucker. This expansion potentially will impact a number of planned water supply projects by the Utility. The City of Riverside Water Utility has joined with eleven other local cities and water agencies in filing a lawsuit against the federal government to overturn the rule. Additionally, a recently formed collaborative between a number of the agencies involved in the lawsuit, the FWS, the California

ECONOMIC FACTORS AND RATES (CONTINUED)

Department of Fish and Game, and the US Army Corps of Engineers is seeking projects to improve habitat and serve as mitigation for planned projects within the Santa Ana River. The Utility will remain engaged and will continue to advocate at the state and federal level for sound environmental policy.

In 2010, the California Environmental Protection Agency (EPA) promulgated a Public Health Goal for Hexavalent Chromium, also known as Chrome-6. Water supply from underground aquifers in the Riverside and San Bernardino areas contain trace levels of naturally occurring Hexavalent Chromium, but at levels well exceeding the Public Health Goal. The US EPA is also developing new drinking water standards for Hexavalent Chromium. Depending on the final drinking water standard adopted, there is significant potential impact to water supply costs. Management continues to monitor the progress of these rules and advocating for development of standards that are protective of human health and based on the best available science.

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/Administration, Riverside Public Utilities, 3901 Orange Street, Riverside, CA 92501. Additional financial information can also be obtained by visiting RiversidePublicUtilities.com.

Financial Statements: Water

BALANCE SHEETS

ASSETS	June 30, 2011	June 30, 2010
	(in thousands)	
UTILITY PLANT:		
Source of supply	$ 63,813	$ 62,820
Pumping	25,564	24,673
Treatment	23,976	23,947
Transmission and distribution	373,973	356,201
General	14,356	14,080
	501,682	481,721
Less accumulated depreciation	(151,154)	(141,167)
	350,528	340,554
Land	10,861	10,809
Intangible	6,307	6,307
Construction in progress	24,568	15,122
Total utility plant (Note 3)	392,264	372,792
RESTRICTED ASSETS:		
Cash and cash equivalents (Note 2)	5,684	6,433
Cash and investments at fiscal agent (Note 2)	61,287	86,907
Total restricted non-current assets	66,971	93,340
OTHER NON-CURRENT ASSETS:		
Deferred pension costs	5,480	5,605
Deferred bond issuance costs	1,957	2,076
Deferred debits (Note 4)	-	6,580
Total other non-current assets	7,437	14,261
Total non-current assets	466,672	480,393
CURRENT ASSETS:		
Unrestricted assets:		
Cash and cash equivalents (Note 2)	56,804	29,370
Accounts receivable, less allowance for doubtful accounts 2011 $261; 2010 $318	9,385	9,620
Accrued interest receivable	435	185
Prepaid expenses	2	5
Total unrestricted current assets	66,626	39,180
Restricted assets:		
Conservation and Reclamation - Cash and cash equivalents (Note 2)	2,245	2,079
Conservation and Reclamation Programs receivable	116	106
Total restricted current assets	2,361	2,185
Total current assets	68,987	41,365
Total assets	$ 535,659	$ 521,758

See accompanying notes to the financial statements

BALANCE SHEETS

EQUITY AND LIABILITIES	June 30, 2011 (in thousands)	June 30, 2010 (in thousands)
EQUITY:		
Invested in capital assets, net of related debt	$ 241,552	$ 237,366
Restricted for:		
Debt service (Note 5)	5,684	6,433
Conservation and Reclamation Programs	2,316	2,166
Unrestricted	52,181	32,029
Total equity	301,733	277,994
LONG-TERM OBLIGATIONS, LESS CURRENT PORTION (NOTE 4)	209,112	219,414
OTHER NON-CURRENT LIABILITIES:		
Pension obligation (Notes 1 and 4)	5,327	5,466
Postemployment benefits payable (Notes 1 and 4)	1,222	881
Derivative instrument (Note 4)	5,448	7,130
Deferred charges on derivative instrument (Note 4)	482	-
Total other non-current liabilities	12,479	13,477
CURRENT LIABILITIES PAYABLE FROM RESTRICTED ASSETS:		
Accrued interest payable	1,891	1,899
Conservation and Reclamation Programs payable	45	19
Current portion of long-term obligations (Note 4)	4,545	4,660
Total current liabilities payable from restricted assets	6,481	6,578
CURRENT LIABILITIES:		
Accounts payable and other accruals	5,026	3,530
Current portion of long-term obligations (Note 4)	150	150
Customer deposits	678	615
Total current liabilities	5,854	4,295
Total liabilities	233,926	243,764
COMMITMENTS AND CONTINGENCIES (NOTES 6 AND 7)	-	-
Total equity and liabilities	$ 535,659	$ 521,758

See accompanying notes to the financial statements

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN EQUITY

	For the Fiscal Years Ended June 30, 2011	2010
	(in thousands)	
OPERATING REVENUES:		
Residential sales	$ 35,721	$ 33,439
Commercial sales	17,863	16,331
Other sales	1,725	1,720
Wholesale sales	2,745	1,765
Conservation and Reclamation Programs	898	837
Other operating revenue	3,132	3,442
Total operating revenues before (reserve)/recovery	62,084	57,534
Reserve for uncollectible, net of bad debt recovery	(123)	(343)
Total operating revenues, net of (reserve)/recovery	61,961	57,191
OPERATING EXPENSES:		
Operations	24,791	25,972
Maintenance	5,872	5,620
Purchased energy	4,558	4,362
Conservation and Reclamation Programs	748	559
Depreciation	11,386	10,660
Total operating expenses	47,355	47,173
Operating income	14,606	10,018
NON-OPERATING REVENUES (EXPENSES):		
Investment income	2,635	1,815
Interest expense and fiscal charges	(8,912)	(7,886)
Gain on sale of capital assets	1,251	7
Gain on sale of land	-	1,835
Other	910	667
Total non-operating revenues (expenses)	(4,116)	(3,562)
Income before contributions and transfers	10,490	6,456
Capital contributions	1,982	2,052
Transfers out - contributions to the City's general fund	(5,847)	(5,657)
Total capital contributions and transfers out	(3,865)	(3,605)
Income before special item	6,625	2,851
SPECIAL ITEM:		
Intra-entity property sale	17,114	-
Increase in equity	23,739	2,851
EQUITY, BEGINNING OF YEAR	277,994	275,143
EQUITY, END OF YEAR	$ 301,733	$ 277,994

See accompanying notes to the financial statements

STATEMENTS OF CASH FLOWS

	For the Fiscal Years Ended June 30, 2011 (in thousands)	2010
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from customers and users	$ 60,023	$ 58,459
Cash paid to suppliers and employees	(34,101)	(40,102)
Other receipts	910	667
Net cash provided by operating activities	26,832	19,024
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES:		
Transfers out - contributions to the City's general fund	(5,847)	(5,657)
Principal paid on pension obligation bonds	(139)	(118)
Net cash used by non-capital financing activities	(5,986)	(5,775)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Purchase of utility plant	(29,754)	(26,021)
Proceeds from the sale of utility plant	18,379	1,901
Principal paid on long-term obligations	(4,660)	(4,415)
Interest paid on long-term obligations	(9,268)	(7,348)
Proceeds from revenue bonds, including premium	-	102,658
Deposit to escrow account for advance bond refunding	-	(21,765)
Bond issuance costs	(402)	(695)
Capital contributions	3,706	1,127
Net cash (used) provided by capital and related financing activities	(21,999)	45,442
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from investment securities	6,998	82
Income from investments	2,385	1,776
Net cash provided by investing activities	9,383	1,858
Net increase in cash and cash equivalents	8,230	60,549
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR **(including $87,736 and $26,878 at June 30, 2010 and June 30, 2009, respectively, reported in restricted accounts)**	117,106	56,557
CASH AND CASH EQUIVALENTS, END OF YEAR **(including $68,532 and $87,736 at June 30, 2011 and June 30, 2010, respectively, reported in restricted accounts)**	$ 125,336	$ 117,106
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating income	$ 14,606	$ 10,018
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	11,386	10,660
Amortization of deferred charges-pension costs	125	100
(Increase) decrease in allowance for uncollectible accounts	(57)	104
(Increase) decrease in accounts receivable	(2,067)	767
Decrease in prepaid expenses	3	2
Increase (decrease) in accounts payable and other accruals	1,496	(3,700)
Increase in postemployment benefits payable	341	355
Increase (decrease) in Conservation & Reclamation Programs	26	(3)
Increase in customer deposits	63	54
Other receipts	910	667
Net cash provided by operating activities	$ 26,832	$ 19,024
SCHEDULE OF NON-CASH INVESTING, CAPITAL AND FINANCING ACTIVITIES:		
Capital contributions - capital assets	626	744
Principal balance of revenue bonds refunded	59,000	-

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 of Riverside (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. The accompanying financial statements present only the financial position and the results of operations of the Water Utility (the Utility), which is an enterprise fund of the City, and are not intended to present fairly the financial position and results of operations of the City in conformity with generally accepted accounting principles. However, certain disclosures are for the City as a whole, since such information is generally not available for the Fund on a separate fund basis. All amounts, unless otherwise indicated, are expressed in thousands of dollars.

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 Utility are also in conformity with the Uniform System of Accounts prescribed by the California Public Utilities Commission. The Utility is not subject to the regulations of the California Public Utilities Commission. The 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

The Water Utility customers are billed monthly. Unbilled water service charges including the Conservation and Reclamation Programs, are recorded at year-end and are included in accounts receivable. Unbilled accounts receivable totaled $3,355 at June 30, 2011, and $3,120 at June 30, 2010.

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

The Water Utility defines capital assets as assets with an initial, individual cost of more than five thousand dollars and an estimated useful life in excess of one year. 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. Intangible assets that cost more than one hundred thousand dollars with useful lives of at least three years are capitalized and are recorded at cost.

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

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 Water Utility began collecting a surcharge for 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, to be in effect for services rendered on or after June 1, 2004 through May 31, 2014. 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. The activity associated with the surcharge is reflected in the accompanying financial statements on the Balance Sheets, Statements of Revenues, Expenses and Changes in Equity, and Statements of Cash Flows.

CASH AND INVESTMENTS

In accordance with Water Utility policy, the 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 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 Utility values its cash and investments in accordance with provisions of Governmental Accounting Standards Board 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, 2011, 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 Water Utility and are pledged as collateral for payment of principal and interest on outstanding bonds, or for use on construction of capital assets.

DERIVATIVES

On July 1, 2009, the Water Utility adopted GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments* (GASB 53). This Statement requires the Utility to report its derivative instruments at fair value. Changes in fair value for effective hedges are to be reported as deferrals on the Balance Sheets. Changes in fair value of derivative instruments not meeting the criteria for an effective hedge, or that are associated with investments are to be reported in the investment section of the Statements of Revenue, Expenses and Changes in Equity.

The Utility has determined that its interest rate swaps associated with variable rate obligations are derivative instruments under GASB 53. The swaps are comprised of an "At-the-Market Swap" derivative instrument and an "Off-Market Swap" deferral balance as described below.

The Utility's evaluation of the "At-the-Market Swap" has concluded that it is an effective hedge under the synthetic instrument method. As a result, upon implementation of GASB 53 beginning July 1, 2009, the negative fair value of the "At-the-Market Swap"

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

has been recorded and deferred on the Balance Sheets. The Balance Sheets for June 30, 2009 have been restated to reflect the retroactive application of GASB 53. Disclosure requirements are presented in Note 4 under Interest Rate Swaps on Revenue Bonds.

The “Off-Market Swap” deferral balance was a result of the refunding of variable rate obligations that occurred in 2008 and 2011. Under GASB 53, hedge accounting ceased to be applied on the interest rate swaps associated with the obligations upon the occurrence of the refunding. Since new variable rate bonds were issued in the refunding, the deferral balance has been treated as a deferred loss and is included in the net carrying amount of the new bonds as reported on the Balance Sheets under long-term obligations.

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

Bond premium/discounts, issuance costs and gains and losses on refunding (including gains and losses related to interest rate swap transactions) are deferred and amortized over the term of the bonds using the effective interest method. Bond premium/discounts, 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.

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, 2011 and 2010 was $678 and $615, respectively (including $115 and $112, respectively, held on behalf of La Sierra Water Company pending dissolution and distribution of remaining cash asset to shareholders, of which the Utility is the largest owner).

COMPENSATED ABSENCES

The accompanying financial statements include accruals for salaries, fringe benefits and compensated absences due to employees at June 30, 2011 and 2010. The Water Utility including the Conservation and Reclamation Programs, treats compensated absences due to employees as an expense and a current liability. The amount accrued for compensated absences was $1,429 at June 30, 2011, and $1,460 at June 30, 2010, and is included in accounts payable and other accruals 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.

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 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 $1 billion.

City-wide information concerning risks, insurance policy limits and deductibles and designation of general fund balance for risks for the year ended June 30, 2011, may be found in the notes to the City’s “Comprehensive Annual Financial Report.”

Although the ultimate amount of losses incurred through June 30, 2011 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 including the Conservation and Reclamation Programs, were $620 and $528 for the years ended June 30, 2011 and 2010, respectively. Any losses above the City’s reserves would be covered through increased rates charged to the Utility in future years.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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, 2011 and 2010 was 14.51 percent and 14.22 percent, respectively, of annual covered payroll. The Utility pays both the employee and employer contributions. The total Water Utility's contribution to PERS including the Conservation and Reclamation Programs as of June 30, 2011 and 2010 was $2,603 and $2,633, respectively.

City-wide information concerning elements of the unfunded actuarial accrued liabilities, contributions to PERS for the fiscal year ended June 30, 2011, 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, 2011.

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. 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 Bond proceeds were deposited with PERS to fund the unfunded actuarial accrued liability for non-safety employees. The balance in deferred pension costs as of June 30, 2011 and 2010 was $5,480 and $5,605, 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, 2011.

OTHER POSTEMPLOYMENT 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 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 Utility for the Stipend Plan are established and may be amended through the MOU between the City and the unions. The Utility's contribution is financed on a "pay-as-you-go-basis" and the current contribution is unfunded. The contribution requirements of the Utility's Implied Subsidy Plan are established by the City Council. The 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.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The 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. *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions (GASB 45)*. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost 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 including the Conservation and Reclamation Programs as of June 30, 2011 and 2010 was $1,228 and $883, respectively.

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, 2011 can be found in the notes to the City's "Comprehensive Annual Financial Report" for the fiscal year ended June 30, 2011.

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 of Riverside 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 ended June 30, 2011 and 2010, the Water Utility transferred 11.5 percent of gross operating revenues less wholesale sales and Conservation and Reclamation Programs revenues, or $5,847 and $5,657, 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 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 Water Utility's prior year financial statements, from which this selected financial data was derived.

NOTE 2. CASH AND INVESTMENTS

Cash and investments at June 30, 2011 and 2010, consist of the following (in thousands):

	June 30, 2011	June 30, 2010
	Fair Value	
Equity interest in City Treasurer's investment pool	$ 64,733	$ 37,882
Cash and investments at fiscal agent	60,764	83,950
	125,497	121,832
Certificate of Deposit with financial institutions at fiscal agent[3]	523	2,957
Total cash and investments	$ 126,020	$ 124,789

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

	June 30, 2011	June 30, 2010
Unrestricted cash and cash equivalents	$ 56,804	$ 29,370
Restricted cash and cash equivalents	7,929	8,512
Restricted cash and investments at fiscal agent	61,287	86,907
Total cash and investments	$ 126,020	$ 124,789

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

		Remaining Maturity (In Months)		
Investment Type	Total	12 Months or less	13 to 24 Months	25 to 60 Months
Held by fiscal agent				
Money market funds	$ 3,909	$ 3,909	$ -	$ -
Investment contracts [1]	56,855	56,855	-	-
City Treasurer's investment pool [2]				
Money market funds	4,833	4,833	-	-
Federal agency securities	30,935	2,679	11,473	16,783
Corp medium term notes	8,366	1,630	2,523	4,213
State investment pool	19,861	19,861	-	-
Negotiable Certificate of Deposit	738	-	40	698
Total [3]	$ 125,497	$ 89,767	$ 14,036	$ 21,694

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

		Rating as of Year End		
Investment Type	Total	AAA	AA	Unrated
Held by fiscal agent				
Money market funds	$ 3,909	$ 3,909	$ -	$ -
Investment contracts	56,855	-	-	56,855
Corp medium term notes	-	-	-	-
City Treasurer's investment pool [2]				
Money market funds	4,833	3,140	1,693	-
Federal agency securities	30,935	30,935	-	-
Corp medium term notes	8,366	8,366	-	-
State investment pool	19,861		-	19,861
Negotiable Certificate of Deposit	738			738
Total [3]	$ 125,497	$ 46,350	$ 1,693	$ 77,454

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

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

3 $523 in Certificates of Deposits is not considered an investment under GASB Statement No. 40, *Deposit and Investment Risk Disclosures.*

NOTE 3. UTILITY PLANT

The following is a summary of changes in utility plant during the fiscal years ended June 30, 2011 and 2010 (in thousands):

	Balance, As of 6/30/2009	Additions	Retirements/ Transfers	Balance, As of 6/30/2010	Additions	Retirements/ Transfers	Balance, As of 6/30/2011
Source of supply	$ 61,392	$ 1,428	$ -	$ 62,820	$ 993	$ -	$ 63,813
Pumping	20,782	3,891	-	24,673	891	-	25,564
Treatment	23,772	175	-	23,947	29	-	23,976
Transmission and distribution	327,189	29,428	(416)	356,201	18,678	(906)	373,973
General	13,275	1,494	(689)	14,080	783	(507)	14,356
Depreciable utility plant	446,410	36,416	(1,105)	481,721	21,374	(1,413)	501,682
Less accumulated depreciation:							
Source of supply	(11,907)	(1,205)	-	(13,112)	(1,247)	-	(14,359)
Pumping	(7,248)	(540)	-	(7,788)	(601)	-	(8,389)
Treatment	(3,929)	(772)	-	(4,701)	(776)	-	(5,477)
Transmission and distribution	(100,735)	(6,939)	467	(107,207)	(7,531)	906	(113,832)
General	(7,733)	(1,256)	630	(8,359)	(1,230)	492	(9,097)
Accumulated depreciation	(131,552)	(10,712)	1,097	(141,167)	(11,385)	1,398	(151,154)
Net depreciable utility plant	314,858	25,704	(8)	340,554	9,989	(15)	350,528
Land	10,809	-	-	10,809	95	(43)	10,861
Intangible	6,015	303	(11)	6,307	-	-	6,307
Construction in progress	24,407	27,435	(36,720)	15,122	30,068	(20,622)	24,568
Nondepreciable utility plant	41,231	27,738	(36,731)	32,238	30,163	(20,665)	41,736
Total utility plant	$ 356,089	$ 53,442	$ (36,739)	$ 372,792	$ 40,152	$ (20,680)	$ 392,264

NOTE 4. LONG-TERM OBLIGATIONS

The following is a summary of changes in long-term obligations during the fiscal years ended June 30, 2011 and 2010 (in thousands):

	Balance As of 6/30/2009	Additions	Reductions	Balance As of 6/30/2010	Additions	Reductions	Balance As of 6/30/2011	Due Within One Year
Revenue bonds	$ 146,588	$ 102,041	$ (25,354)	$ 223,275	$ 50,010	$ (60,425)	$ 212,860	$ 4,545
Pension obligation	5,584	-	(118)	5,466	-	(139)	5,327	163
Postemployment benefits payable	526	355	-	881	341	-	1,222	-
Water stock acquisition rights	949	-	-	949	-	(2)	947	150
Total long-term obligations	$ 153,647	$ 102,396	$ (25,472)	$ 230,571	$ 50,351	$ (60,566)	$ 220,356	$ 4,858

NOTE 4. LONG-TERM OBLIGATIONS (CONTINUED)

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

Contracts Payable	**June 30, 2011**	**June 30, 2010**
Water Stock Acquisitions: Payable on demand to various water companies	$ 947	$ 949
Total contracts payable	947	949
Revenue Bonds Payable		
$69,840 1991 Water Revenue Bonds: All bonds outstanding were fully matured on October 1, 2010	-	3,235
$20,000 2001 Water Revenue Bonds: serial bonds due in annual installments from $470 to $510 through October 1, 2013, interest from 4.0 percent to 4.4 percent (partially advance refunded in 2005 and 2009 with final maturity in 2013)	1,470	1,920
$60,300 2008 Water Refunding/Revenue Series A Bonds: All outstanding bonds were refinanced with the 2011 series A Revenue/Refunding Bonds on May 26, 2011	-	59,450
$58,235 2008 Water Revenue Series B Bonds: fixed rate bonds due in annual installments from $1,210 to $7,505 from October 1, 2016 through October 1, 2038, interest from 4.0 percent to 5.0 percent	58,235	58,235
$31,895 2009 Water Refunding/Revenue Series A Bonds: fixed rate bonds due in annual installments from $500 to $3,835 through October 1, 2020, interest from 0.65 percent to 5.0 percent	31,370	31,895
$67,790 2009 Water Revenue Series B Bonds: fixed rate, federally taxable, Build America Bonds due in annual installments from $2,475 to $4,985 through October 1, 2039, interest from 3.3 percent to 4.1 percent	67,790	67,790
$59,000 2011 Water Revenue/Refunding Series A Bonds: variable rate bonds due in annual installments from $800 to $3,950 through October 1, 2035. Interest rate is subject to weekly repricing (net interest rate, including swaps, at June 29, 2011 was 3.2 percent)	59,000	-
Total water revenue bonds payable	217,865	222,525
Total water revenue bonds and contracts payable	218,812	223,474
Unamortized deferred bond refunding costs	(9,802)	(4,127)
Unamortized capital appreciation	-	(110)
Unamortized bond premium	4,797	4,987
Total water revenue bonds and contracts payable, net of deferred bond refunding costs, capital appreciation, and bond premium	213,807	224,224
Less current portion	(4,695)	(4,810)
Total long-term water revenue bonds and contracts payable	$ 209,112	$ 219,414

Annual debt service requirements to maturity, as of June 30, 2011, are as follows (in thousands):

	2012	2013	2014	2015	2016	2017-2021	2022-2026	2027-2031	2032-2036	2037-2041	Total
Principal	$ 4,695	$ 4,845	$ 5,020	$ 5,165	$ 5,410	$ 28,372	$ 33,990	$ 41,110	$ 49,955	$ 40,250	$ 218,812
Interest	8,840	8,678	8,487	8,276	8,046	36,753	30,773	23,417	14,296	3,234	150,800
Total	$ 13,535	$ 13,523	$ 13,507	$ 13,441	$ 13,456	$ 65,125	$ 64,763	$ 64,527	$ 64,251	$ 43,484	$ 369,612

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 3.49 and 2.08 at June 30, 2011 and 2010, respectively. The debt (revenue bonds) is backed by the revenues of the Utility.

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 Utility's financial statements. At fiscal year ended June 30, 2011, $14,995 of bonds outstanding is considered defeased.

2011 WATER REFUNDING/REVENUE BONDS

In May 2008, the Water Utility refinanced $60,300 of Auction Rate Securities (ARS) with Variable Rate Demand Notes (VRDNs). Due to the 2008 financial market meltdown, the ARS experienced failed auctions. VRDNs in conjunction with the Utility's interest rate hedges (discussed in the Interest Rate Swaps on Revenue Bonds section below) have proven to be very effective in lowering the overall debt costs. VRDNs require additional credit enhancements (e.g. insurance or a bank letter of credit) to ensure timely payment to the bondholders. In 2008, the Utility used Letters of Credit (LOC) provided by Bank of America/Merrill Lynch (BAML), at very attractive rates, which required BAML to make debt service payments to bondholders should the Utility fail to make payment. The LOC with BAML expired in May 2011 and due to the number of entities seeking to renew their expiring LOCs combined with the shrinking number of highly-rated banks offering this service, renewing the existing LOC with BAML resulted in higher rates. Therefore, the Utility decided to restructure the 2008 VRDNs in order to mitigate various risk exposures and to provide an overall lower cost of financing by refunding the 2008 VRDNs with the 2011 VRDNs (as described below).

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 26, 2011, $59,000 of Water Refunding/Revenue Series A Bonds were sold with an all-in true interest cost of 3.33% to refund $59,000 of previously outstanding 2008 Water Refunding/Revenue Bonds. The refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of $434. The difference is being charged to operations using the proportional method. Principal payments are due on October 1, 2011 until the maturity date of October 1, 2035 ranging from $800 to $3,950.

INTEREST RATE SWAPS ON REVENUE BONDS

The Water Utility has one cash flow hedging derivative instrument, which is a pay-fixed swap. The swap was determined to be hedge-effective under the synthetic instrument method. The change in fair value for fiscal year 2011 was recorded in the deferred charges on derivative instrument on the Balance Sheets.

A summary of the derivative activity for the year ended June 30, 2011 is as follows:

	Notional Amount	Fair Value as of 6/30/2011	Change in Fair Value for Fiscal Year
2011 Water Refunding/Revenue Bonds Series A	$ 59,000	$ (5,448)	$ 1,682

Objective: In order to lower borrowing costs as compared to fixed-rate bonds, the Utility entered into interest rate swap agreement in connection with its $59,000 2011 Water Refunding/Revenue Series A Bonds.

Terms: Per the existing swap agreement, the Utility 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 swap has a notional amount equal to the principal amount stated above. The notional value of the swap and principal amount of the associated debt decline by $800 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 agreement for the 2011 Water Refunding/Revenue Series A Bonds mature on October 1, 2035. As of June 30, 2011, rates were as follows:

Interest rate swap:	Terms	Rates
Fixed payment to counterparty	Fixed	3.20000%
Variable payment from counterparty	62.68 LIBOR + 12bps	(0.24207%)
Net interest rate swap payments		2.95793%
Variable-rate bond coupon payments		0.22550%
Synthetic interest on bonds		3.18343%

Fair value: As of June 30, 2011, in connection with the swap agreement, the transactions had a total negative fair value of ($5,448). Because the coupons on the Utility'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, 2011, the Utility was not exposed to credit risk because the swap had a negative fair value. The swap counterparty, J.P. Morgan Chase & Co. was rated A+ by Standard & Poor's. To mitigate the potential for credit risk, the swap agreement requires the fair value of the swap to 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, 2011, there is no requirement for collateral posting for the outstanding swap.

Basis risk: As noted above, the swap exposes the Utility to basis risk should the relationship between LIBOR and the variable rates 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 Utility if the counterparty's credit quality falls below "BBB-" as issued by Standards & Poor's. The Utility 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 Utility would be liable to the counterparty for a payment equal to the swap's fair value.

Swap payments and associated debt: As of June 30, 2011, 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.

	Variable-Rate Bonds			
Fiscal Year Ending June 30,	**Principal**	**Interest**	**Interest Rate Swaps, Net**	**Total**
2012	$ 800	$ 131	$ 1,721	$ 2,652
2013	825	129	1,697	2,651
2014	850	127	1,672	2,649
2015	875	126	1,646	2,647
2016	925	123	1,619	2,667
2017-2021	8,625	569	7,459	16,653
2022-2026	13,550	430	5,644	19,624
2027-2031	15,175	267	3,496	18,938
2031-2035	17,375	84	1,096	18,555
Total	$ 59,000	$ 1,986	$ 26,050	$ 87,036

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 the Utility's water revenue and refunding bonds require debt service reserves that equate to the maximum annual debt service required in future years and bond service reserves of three months interest and nine months principal due in the next fiscal year. Variable rate revenue and refunding bonds require 110% of the monthly accrued interest to be included in the reserve. Certain bond issues are covered by a Surety Bond (2008 Revenue Series B) and certain issues have no debt service reserve requirements (2009 Revenue/Refunding Series A, 2009 Revenue Series B and 2011 Refunding Series A bonds).

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 Utility are incidental to the ordinary course of operations of the 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 Utility.

The Utility is a plaintiff in a lawsuit against several entities that either owned or leased a property site in the City of Colton and City of Rialto that is contaminated by perchlorate. The lawsuit was filed March 31, 2009, and no trial date has been set.

NOTE 7. CONSTRUCTION COMMITMENTS

As of June 30, 2011, the Water Utility had major commitments (encumbrances) of approximately $9,033 with respect to unfinished capital projects which is expected to be funded by bonds.

NOTE 8. SPECIAL ITEM

On January 4, 2011 and March 1, 2011, City Council approved the sale of the 56-acre AB Brown Sports Complex and a certain property (Reid Park land and a 64 acre portion of the former Riverside Golf Course) from the Water Utility to the Electric Utility. The properties were sold for a fair market value of $11,600 (AB Brown Sports Complex) and $5,558 ($720 Reid Park and $4,838 Riverside Golf Course), respectively. The original and carrying value of the properties is $17 and $27, respectively. The balance between the sales price and carrying value of $11,583 and $5,531, respectively, is recorded as a special item.


INLINE

Key Historical Operating Data: Water

KEY HISTORICAL OPERATING DATA

WATER SUPPLY (ACRE FEET)

	2010/11	2009/10	2008/09	2007/08	2006/07
Pumping	66,492	69,676	76,830	80,974	85,299
Purchases	0	0	0	1,643	2,092
Total:	66,492	69,676	76,830	82,617	87,391
Percentage pumped	100.00%	100.00%	100.00%	98.0%	97.6%
System peak day (gallons)	90,556,000	98,017,000	105,780,000	111,300,000	109,200,000

WATER USE

	2010/11	2009/10	2008/09	2007/08	2006/07
Number of meters as of year end					
Residential	58,460	58,372	58,152	57,694	57,666
Commercial/Industrial	5,482	5,451	5,519	5,446	5,279
Other	407	408	391	354	486
Total:	64,349	64,231	64,062	63,494	63,431
*CCF sales					
Residential	15,698,321	16,321,425	17,898,798	18,483,522	19,848,653
Commercial/Industrial	9,219,913	9,344,085	10,342,284	10,510,953	10,817,783
Other	826,165	871,396	983,553	970,239	1,243,927
Subtotal:	25,744,399	26,536,906	29,224,635	29,964,714	31,910,363
Wholesale	158,040	150,365	496,601	618,552	199,845
Total:	25,902,439	26,687,271	29,721,236	30,583,266	32,110,208

*(CCF equals 100 cubic feet)

WATER FACTS

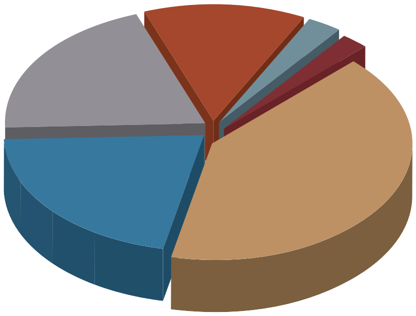
	2010/11	2009/10	2008/09	2007/08	2006/07
Average annual CCF per residential customer	269	280	308	320	345
Average price ($/CCF) per residential customer	$2.28	$2.05	$1.81	$1.63	$1.43
Debt service coverage ratio (DSC)[2]	3.49	2.08	2.25	3.88	3.38
Employees[1]	180	178	167	167	165

[1]Approved positions

[2]For FY 09/10 and thereafter, interest expense used to calculate DSC is net of federal subsidy on Build America Bonds.

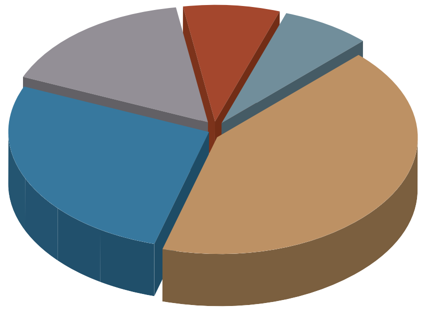
2010/2011 WATER REVENUE AND RESOURCES

Source of Revenue



- Residential Sales 41¢
- Commercial Sales 21¢
- Special Item 20¢
- Other Revenues 13¢
- Investment Income 3¢
- Other Sales 2¢

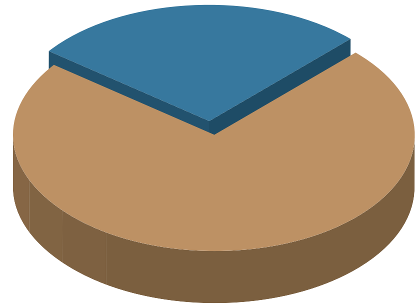
Distribution of Revenue



- Operations and Maintenance 42¢
- Additional Reserves 27¢
- Debt Services 16¢
- Additions and Replacements to the System 8¢
- Transfers to the City's General Fund* 7¢

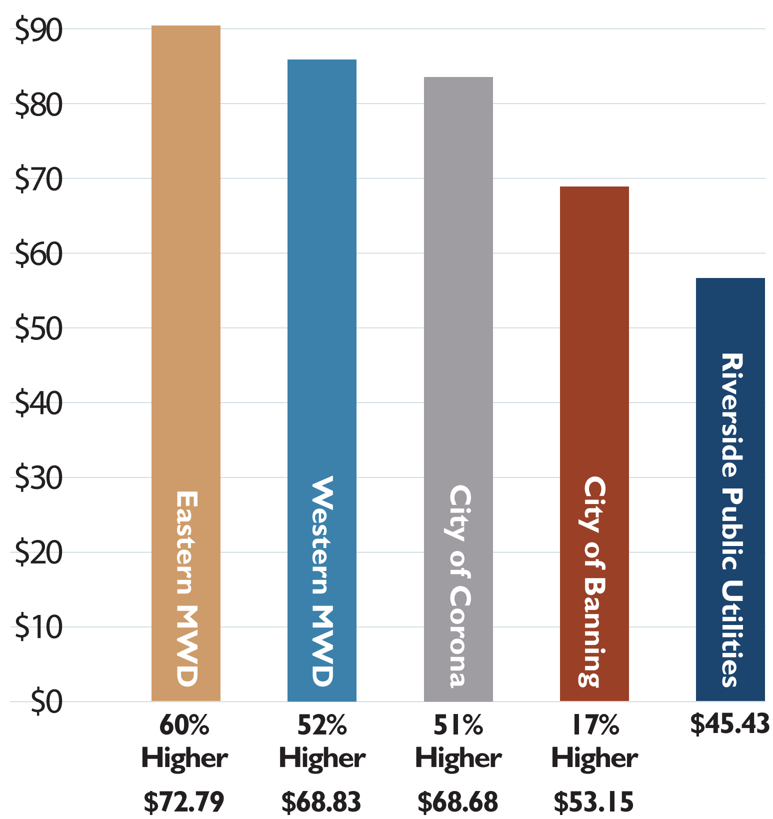
** Based on transfer of 11.5% of fiscal year 2009/2010 operating revenues (excludes wholesale sales and Conservation and Reclamation revenue).*

Water Resources

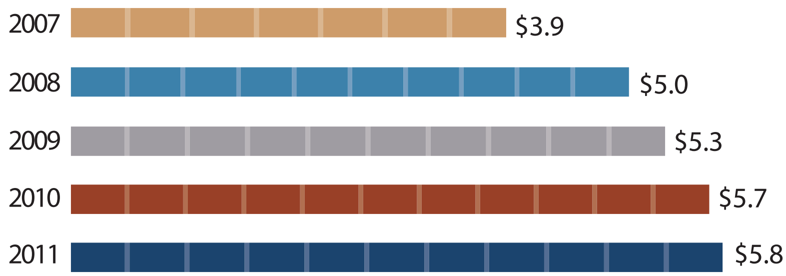


- San Bernardino Basin Wells 73%
- Riverside Basin Wells 27%
- Purchased Water 0%

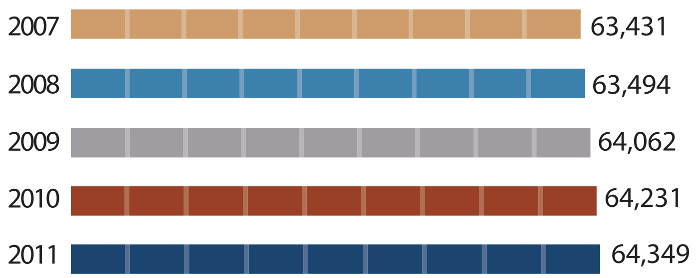
RESIDENTIAL WATER RATE COMPARISON – 23 CCF PER MONTH (AS OF JUNE 30, 2011)



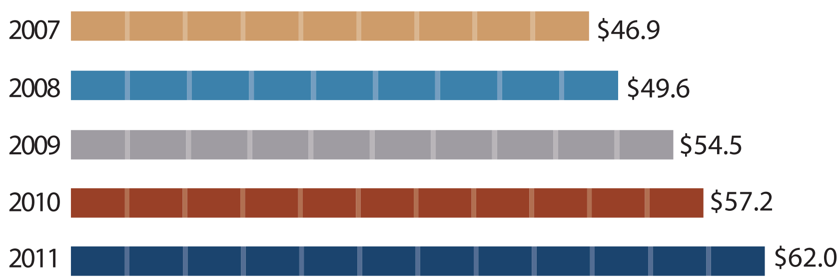
GENERAL FUND TRANSFER (IN MILLIONS)



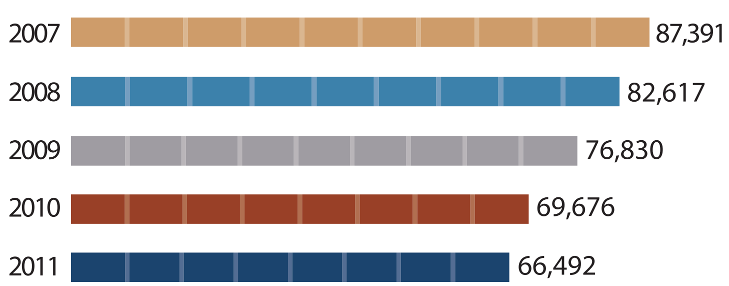
NUMBER OF METERS AT YEAR END



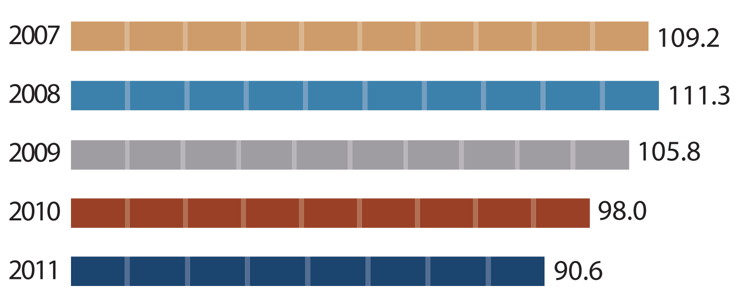
TOTAL OPERATING REVENUE (IN MILLIONS)



PRODUCTION (IN ACRE FEET)



PEAK DAY DEMAND (IN MILLION GALLONS)



WATER FACTS AND SYSTEM DATA

Established	1913
Service Area Population	306,779
Service Area Size (square miles)	74.4
System Data:	
Smallest pipeline	2.0”
Largest pipeline	72.0”
Miles of pipeline	1,002
Number of domestic wells	52
Number of active reservoirs	15
Total reservoir capacity (gallons)	92,500,000
Number of treatment plants	6
Number of treatment vessels	95
Miles of canal	14
Number of fire hydrants	7,632
Daily average production (gallons)	57,947,719
2010-2011 Peak day (gallons)	90,556,000
07/19/10, 105 degrees	
Historical peak (gallons)	118,782,000
08/09/05, 99 degrees	

Bond Ratings

Fitch Ratings	AA+
Moody’s	Aa2
Standard & Poor’s	AAA