

BUDGET MEMORANDUM

TO: ELCO Board Members
FROM: Mike Scheid, ELCO General Manager
RE: 2010 ELCO Water District Budget
DATE: December 15, 2009

A Review of 2009

Financial

In 2008, new residential and commercial development within the District's service area slowed considerably. In 2009, it ground to a halt. No new plans for residential or commercial lots were submitted to the District this past year. The only development related activity within the District was continued plan review of existing projects.

In early 2009, ELCO retained Red Oak Consulting to complete a high level review the District's financial plan. In 2008, Red Oak completed a comprehensive plant investment fee (PIF), financial planning and rate study. The 2008 Rate Study reflected an anticipated high level of growth and new customers connecting to the water system. The District experienced a slower rate of growth in 2008 than expected and anticipated an even slower rate of growth in 2009. Given the state of the economy, the ELCO Board determined that a more detailed review of the Districts Financial plans would be appropriate later in the year after water usage and revenue data was available. In late July 2009, ELCO staff began responding to data requests from Red Oak to complete a more in depth 2009 financial plan and rate update. Results of the most recent study indicated that the District needs to increase rates by approximately 12% in 2010.

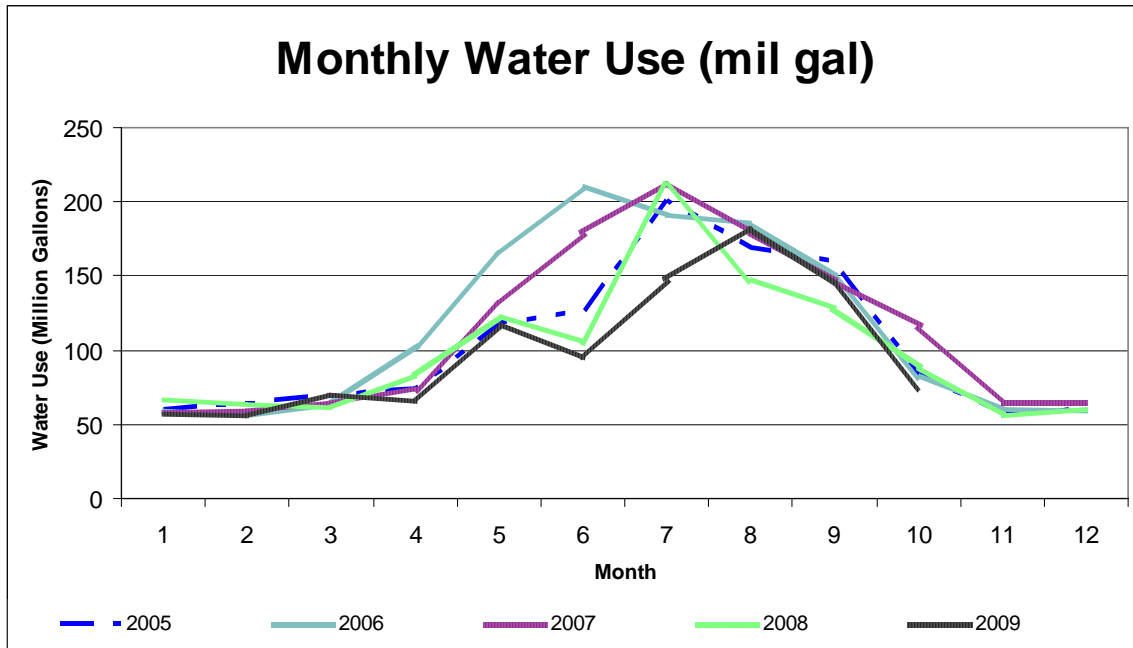
Plant investment fee (PIF) revenue collected in 2009 from approximately 50 new residential and zero new commercial customers totaled \$354,220. To date, ELCO serves 5,798 customer accounts and an estimated population of 17,000.

Metered water sales for 2009 total nearly \$2.2 million, 11% less than the amount budgeted.

On May 27, the District issued debt for NEWT 1 pipeline project construction and refunding of the outstanding 1998 debt:

- Water Enterprise Revenue Bonds, Series 2009A: \$3,610,000 (NEWT 1)
- Water Enterprise Revenue Refunding Bonds, Series 2009B: \$4,315,000 (Refunding)

Water usage is down approximately 6.2% from 2008 to 3,000 acre feet. ELCO will end the year with approximately 2,000 acre feet of C-BT carryover water for use in 2010. The following graph shows monthly demands of ELCO customers over the past five years.



Engineering

Much time was spent during first half of the year on easement acquisition, final design and the bidding process for the NEWT 1 Pipeline project. In September, ELCO and North Weld began construction on the 4.4 mile long, 42 inch diameter pipeline. The Districts began design work on the pipeline in 2005. This is the first of two phases which will ultimately extend from the Soldier Canyon Filter Plant to the North Weld pump station located on Timberline Road. NEWT 1 construction is expected to be finished in the spring of 2010.

In 2009, the District continued development of the ELCO Geographic Information System (GIS) created in 2008. This system integrates Global Positioning System (GPS) hardware, software, and new or existing ELCO data, for managing, analyzing, and displaying geographically referenced information. Development of the ELCO GIS will be an on-going effort, incorporating new information and expanding over time to the point where it will replace the current CAD based mapping system used throughout the organization.

Field Operations

The ELCO field crew has been involved in several improvement projects during 2009. The District coordinated with Larimer County to replace approximately 730 feet of undersized waterline with new 6-inch PVC prior to the reconstruction of Travis Road between the Water Supply and Storage #4 and Kluver Reservoirs. ELCO also replaced 400 feet of undersized waterline along the Northeast frontage road with new 8-inch PVC in advance of reconstruction of the intersection east of I-25 on Highway 14.

Additional field crew activity during 2009 includes:

- Installed variable frequency drive (VFD) on pump #2 at pump station 1
- Replaced valves on pump station 1 pumps
- Replaced tank 1 hatch
- Replaced bearings on pump station 1 pumps
- Drained and cleaned tank 1
- Installed ground loops at pump stations 1 and 2
- Performed interior maintenance and rehab work on tank 2
- Installed on-line chlorine monitor at pump station 3
- Replacement of 15 hp pump motor at pump station 3
- Rebuilt target system/ tank level indicator at tank 3
- Replacement of all pump station controls
- Refined transition and operation of seasonal pressure zone configurations
- Performed maintenance on approximately 200 of 742 District fire hydrants
- Raised and maintained various valve boxes, ARV and PRV pits and vaults.
- Performed freeze protection on approximately 35 meter pits
- Began recording locations of residential meter pits with GPS
- Installed sampling stations for monthly total coliform sampling
- Installed 10-inch check valve assembly and vault in Lemay Ave
- Installed new valves and pipe in Lemay Ave. in anticipation of Greeley and NEWT waterline construction
- Performed tapping work for Soldier Canyon Filter Plant
- Performed leak detection on approximately 15 miles or 10% of District transmission and distribution waterline
- Installed automatic gate opener at ELCO shop/office

ELCO continues to require the installation of backflow devices on all new meter installations. In 2009, the District performed on-site audits of approximately 6 commercial customers.

Administrative

As part of the District's water conservation effort ELCO again offered free sprinkler audits of residential irrigation systems. In 2009, the District performed sprinkler audits for approximately 20 residential customers. ELCO has also submitted an application for a water efficiency grant to the Colorado Water Conservation Board (CWCB) for leak detection on District and mobile home park water lines.

The District continues to make information available to customers, developers and consultants through its website, www.elcowater.org. The website features a link for online account access and bill payment. Approximately 219 customers use this payment method each month. In October 2008, the District began accepting billing payments via credit card for walk-in and phone payments during business hours. On average, 35 customers per month make payment using a credit card.

Additional administrative activity during 2009 includes:

- Amendment of the 2009 budget to accommodate unanticipated revenue
- Inter-office cross-training (billing, and accounting)
- Ongoing research with goal of wellness program for all District employees
- Developed and implemented system to comply with Red Flag Alert requirements to help prevent identity theft
- Provided data and historical information in support of 2009 Bond Issue (process was made more efficient by the use of routinely maintained billing and usage data spreadsheets)
- HRA and PTO policies developed by administrative personnel have now been in place for a full year – each of which is has been well received by District staff
- Converted all Accounts Payable files to a paperless system (plan is to convert administrative files in 2010)
- Implemented automatic call forward and un-forward of the phones
- Implemented system which automatically converts incoming faxes to email which are then distributed increasing efficiency and reducing waste

Water Resources

During 2009, the District continued improving facilities, developing water rights and storage in the Poudre River Basin. The development of most water rights and storage projects continues to be through partnerships with neighboring cities and districts. Cooperation between water suppliers continues to reduce overall costs and better utilize the existing resources of each participant.

Attorneys and engineers hired to change the use of the District's Water Supply and Storage Company (WSSC) shares continued working on the water court application filed in December 2003. ELCO owns Poudre River water rights capable of supplying 1,240 acre feet of water during a drought expected to occur once every 50 years. The average year yield of those same water rights is estimated to be 1,763 acre feet. ELCO's water bank currently holds 18.79 WSSC shares.

Since the yield of river rights varies significantly from year to year and month to month, storage reservoirs will be necessary to better manage the District's water rights. ELCO along with North Weld

County Water District, Fort Collins Loveland Water District and the City of Greeley continued the development of storage along the Poudre River downstream of LaPorte. The emphasis during 2009 has been on land, easement and water rights acquisition, as well as the development of carriage agreements.

In May 2005, the District attempted to purchase an interest in the John G. Coy Ditch. In late 2008, ELCO again contacted the owners of the water right and in 2009 acquired an undivided 35% interest in the Coy. Although relatively small, the Coy is a senior water right on the Poudre River that historically irrigated property, now developed, within the District.

Late spring high country snowpack was above average this year. Spring and summer weather was such that we experienced an unusually cool and wet period which as in 2008 extended the runoff season. For the third year in a row, runoff did not peak as it would normally. The District was again able to divert 100% of its class A and B shares of its Divide Canal and Reservoir Company shares.

Precipitation for the water year 2008-2009 in Fort Collins totaled 18.59 inches compared to an average of 14.46 inches which is 129% of normal. 2009 ranks as the 11th wettest water year (Oct-Aug) in the 121 year record.

Halligan

In late July 2009, the ELCO Water District advised the City of Fort Collins that after payment of its pro rata share of all outstanding invoices for services rendered prior to August 1, 2009, ELCO was withdrawing from further participation in the Halligan Seaman Water Management Project (HSWMP).

After careful consideration of the progress of the Project, the anticipated difficulties in obtaining permitting for the Project and the estimated cost of the water resources resulting from completion of the Project, the Board of Directors of ELCO determined that it could not continue funding of the Project. Specifically, the Board of Directors determined that it would not budget or appropriate additional funds to complete the planning and environmental review for permitting the Project.

The District believes that the Project, as initially envisioned, was well conceived as presented by City of Fort Collins Staff and certainly merited ELCO's initial participation. This decision to withdraw was based upon the increasing realization that the lengthy permitting process and continued opposition to this Project required ELCO pursue alternative water resources to satisfy the needs of its constituents in a timely manner.

East Rigden

A November 2006 report by Williams and Weiss Consulting performed for the Flatiron Companies and ELCO indicated that the East Rigden Storage project could satisfy up to 600 acre feet of the Districts return flow storage need when developed. Following the report, the District entered into preliminary agreement discussions along with engineering and financial structure analysis of the potential project with Flatiron Companies. As discussion and analysis of the project continued, needs and options were explored. Further engineering analysis of the project revealed that East Rigden had the potential to be expanded to approximately 1,200 acre feet.

In early 2009, the District met with Flatiron Companies to again discuss a purchase agreement. At that time, it was agreed that given the state of the economy, development of the project could be delayed until

around 2013. It was also agreed that the parties would continue to develop an agreement that met the needs of both. In summer 2009, a representative from Flatiron met with ELCO to discuss the agreement structure.

In October, the District was informed that Flatiron Companies will seek other potential buyers because ELCO and Flatiron could not reach agreement on the structure of the purchase agreement. Unfortunate as this is, ELCO's needs for return flow replacement storage will not occur until after the District's WSSC change case is complete and the water is diverted. Even if ELCO had continued with the development and construction of East Rigden at 1,200 acre feet in 2013, the need for this volume of return flow replacement storage would not occur until approximately 2035.

ELCO anticipated obtaining 5,000 acre feet of storage capacity in an enlarged Halligan Reservoir and 900 to 1,200 acre feet in East Rigden. These needs for storage have not changed. The District is in the process of evaluating storage alternatives that will meet its needs as demand increases, additional water is acquired and water rights change-of-use cases are completed.

2010 Budget Issues

Most of the undeveloped land within the Fort Collins Growth Management Area is located in ELCO's service area. Up until recently, City planning documents indicated the population served by ELCO will increase from 17,000 today to 47,000 by the year 2025. The recent economic downturn has significantly slowed both residential and commercial development in the ELCO service area. This has resulted in a reduction in plant investment fee revenue and pushed the need for capital projects further in the future.

Competition for high quality sources of water with senior decrees is increasing. Water utilities that have historically relied on C-BT water can see the end of agricultural to municipal transfers. There is only a 5 to 10 year inventory of agricultural C-BT units that can be transferred for municipal use. Once all C-BT units are owned by districts and municipalities, the only water remaining for transfer will be mutual ditch company shares owned by farmers. In recent years with demand high, the value of shares in the best ditch companies had been climbing. With the slow down in development and reduction in demand for water, the value of not only ag water rights but C-BT as well, has dropped significantly.

With its water bank, ELCO has created an effective market for willing sellers of mutual ditch company shares to find buyers. At this time, the amount of water bank credit exceeds demand from developers. That situation prevents monopolization by any one depositor and insures competition for sales. Ultimately, new ELCO customers benefit from a competitive market for water to satisfy the District's development requirements. The best water rights in the Poudre basin will be sought by other utilities in the region. Once those supplies are exhausted, the District will need to consider opening the water bank to other sources to maintain a competitive market for water rights.

Any new sources of water considered for satisfaction of development requirements will need to be thoroughly reviewed by engineers and attorneys. There are numerous sources of water from the Poudre River. Some are much better than others. ELCO should focus on sources that continue to yield during a drought, can be changed relatively easily and effectively managed once changed. Competition for water rights meeting those criteria will be intense. ELCO will need to pursue development of obscure water supplies and storage to maximize the availability of water to existing and future customers. In order to make use of future water supplies from the Poudre River Basin and meet related obligations

that will be placed on ELCO, additional storage will be required, ideally in multiple locations along the upper, middle and lower Poudre River. ELCO's 2010 Budget anticipates minimal engineering and legal work related to storage, and land purchases. A raw water acquisition and storage engineering study, currently in work, will aid in identifying ELCO's needs in the development of potential solutions.

In 2009, production at the Soldier Canyon Filter Plant (SCFP) was down approximately 13.5% from 2008. ELCO along with the North Weld County and Fort Collins Loveland Water Districts have begun an analysis of projected Tri-District demands, transmission capacity and filter plant expansion alternatives. The Tri-Districts will continue the discussion with CSU regarding the acquisition of property north of the SCFP for additional drying bed capacity and future plant expansion.

ELCO's 2010 Budget, which was prepared using the modified accrual method of accounting, provides staff, resources and funding to address the issues previously discussed while maintaining reliable and affordable water service for existing customers. The District's most important assets are not its water rights, reservoirs, equipment or facilities; it is the employees of the District. The District's employees are well prepared for what is anticipated in 2010 and the years to come.

Specific issues impacting the 2010 Budget are discussed in detail on the following pages.

Revenues

The proposed budget includes a 12% rate increase effective January 1, 2010 for metered water sales and standby charges necessary to cover increasing operating and maintenance costs.

Due to the projected slow economic growth in Northern Colorado in 2010, Plant Investment Fee (PIF) revenue is expected to decrease by approximately 43% from 2009. The anticipated drop in PIF revenue is based on the projected addition of only 30 new single family customers in 2010. No increase in PIF rates in 2010 is anticipated.

The slow down in residential building also affects the timing of several capital improvement projects ELCO is currently considering. The slowing of growth translates into a less immediate need and a less certain schedule for raw water storage as well as transmission and additional filter plant capacity.

Expenditures

With relatively flat growth and no increase in Poudre Valley REA rates, the estimated cost of power for pump stations is not increasing in 2010.

The District does not anticipate an increase in cost or shortage in supply of asphalt, concrete, aggregate or other materials including pipe in 2010.

The cost of fuel used by the District to provide the service ELCO customers are accustomed to continues to fluctuate. Fuel costs during 2009 decreased 40% from the previous year. The District is however anticipating a 14% increase in fuel cost in 2010.

The cost of raw water assessments is expected to increase as developers transfer water rights to the District and additional sources of water are acquired by the District. ELCO can also expect

carriage charges levied by ditch companies delivering Poudre River water rights to storage.

C-BT assessments will increase 3% next year from \$24.32 to \$25.06 per acre-foot unit. North Poudre assessments are projected to be \$100 per share with Water Supply and Storage Company at \$2,500 per share.

The overall cost of property, casualty and workers' compensation insurance will likely increase by 6.6% in 2010.

Debt Service

On December 15, 1998, ELCO issued \$7,050,000 in Water Revenue Refunding and Improvement Bonds. With interest rates in 2009 at historically low levels, the Board elected to refund outstanding 1998 Bonds and issue new bonds to fund capital improvements and the NEWT 1 Pipeline. ELCO obtained \$7,925,000 in Water Revenue Refunding and Improvement Bonds on May 27, 2009.

Annual debt service on the 2009 Bonds will average \$561,000 over the next 12 years. Payment of principal and interest is guaranteed by a financial guaranty insurance policy issued by Assured Guaranty Corporation. The net effective interest rate on the 2009 bonds is 3.86%. The outstanding principal on the bonds as of December 31, 2009 will be \$7,635,000. Revenue estimates for 2009 are adequate to meet bond covenants that require net revenue to equal or exceed 120% of principal and interest payments. In addition, the District is required by the bond insurer to maintain rates so that gross pledged revenues annually are sufficient to pay annually all Operation and Maintenance expenses and 100% of both principal and interest due on the 2009 bonds, excluding Plant Investment Fees.

Capital Expenditures

A total of \$367,863 is budgeted to: (1) pursue a change-of-use of the District's existing Poudre River water rights, (2) acquire undervalued sources of water for existing and future customers, and (3) secure storage capacity in the Poudre River basin.

For 2010, \$1,325,418 is budgeted for the NEWT 1 project. This includes \$84,418 for final easement settlement payments and \$1,241,000 for remaining construction costs.

Given the current and projected state of the economy and its effect on development, activity on NEWT 2 in 2010 will be limited to initial in-house design and engineering required to secure easements along the approved route.

A total of \$950,000 is budgeted for over sizing waterlines, improving fire flow and the installation of distribution system improvements including approximately 8,000 feet of new 12-inch waterline.

The only change to ELCO staff anticipated in 2010 is the addition of a part-time "non-benefited" position.