



CUSTOMERS • CONSERVATION & EFFICIENCY • QUALITY • SUPPLY • OPERATIONS & SYSTEMS

ANNUAL REPORT

FISCAL YEAR 2013 • JULY 1, 2012 – JUNE 30, 2013



*Ensuring Water Reliability
Today and in the Future*



Page intentionally left blank.

ABOUT TUCSON • TABLE OF CONTENTS

TUCSON, the county seat for Pima County, is the second largest city in Arizona. Incorporated in 1877, Tucson started as a small presidio located in what is now the City's downtown. The City has grown to approximately 300 square miles and lies within a greater metropolitan region of more than 400 square miles with a population of one million people. Tucson Water is southern Arizona's primary water service provider with customers residing both inside and outside the city limits. The Central Arizona Project delivers Colorado River water via 335 miles of canals and pipelines to Tucson Water.



Table of Contents

Introductory Section

- Letter from the Director
- Tucson Mayor and Council

Ensuring Water Reliability Today and in the Future 1

Financial Section 9

- Report of Independent Auditor 11
- Management's Discussion and Analysis (MD&A) 13
- Financial Statements – FY 2013 31
 - Statement of Net Position 33
 - Statement of Revenues, Expenses and Changes in Net Position 35
 - Statement of Cash Flows 37
 - Notes to the Financial Statements 39
- Supplementary Information 69
 - Schedule of Net Revenues Available for Debt Service – FY 2013, UNAUDITED 71
 - Rate Schedule - FY 2013, UNAUDITED 73
 - Schedule of Flow of Funds, Excludes Conservation Program Fund - FY 2013, UNAUDITED 75
 - Schedule of Flow of Funds, Conservation Program Fund - FY 2013, UNAUDITED 78
 - Summary of Flow of Funds - FY 2013, UNAUDITED 79

Page intentionally left blank.

LETTER FROM THE DIRECTOR



Water is our most important and precious natural resource. As the southwest United States becomes warmer and drier, it is essential that Tucson Water has a strategic plan and vision to secure our community's water future.

In fiscal year 2013, Tucson Water announced the *Water Reliability Program*, the Utility's strategic plan, focusing our employees and resources on customers, operations and systems, conservation and efficiency, water supplies and water quality. Simply put, Tucson Water's *Water Reliability Program* includes a series of investments, projects, and programs that, together, ensures our community has an efficient, reliable water supply and water system today and in the future.

Tucson Water believes that a stable and resilient financial position is critical to the long-term success of the *Water Reliability Program*.

This Annual Report Fiscal Year 2013 contains important information about the Utility's financial performance and specifics about *Water Reliability Program* activities. This annual report also reflects a large, complex utility with employees who are efficient, responsive, accountable and forward-thinking. I am proud and pleased to be a part of the Tucson Water team and our vision to deliver safe, high quality water for generations to come.

Sincerely,

Alan Forrest
Director

FY 2013 Citizens' Water Advisory Committee (CWAC)

Mark Taylor, P.E., Chairman
Christopher Brooks, J.D., Vice Chair
Bruce Billings, Ph.D
Evan Canfield, Ph.D., P.E.
W. Mark Day, M.S., M.B.A.

Chuck Freitas
Bob Gilby
James Horvath
Kelly Lee
Amy McCoy, Ph.D.

Thomas Meixner, Ph.D.
Catlow Shipek, M.S.
Alan Tonelson
Vincent Vasquez, M.S.
Brian Wong

Page intentionally left blank.

CITY OF TUCSON MAYOR AND COUNCIL



**Mayor
Jonathan Rothschild**



**Regina Romero,
Ward One**



**Paul Cunningham,
Ward Two**



**Karin Uhlich,
Ward Three**



**Shirley Scott,
Ward Four**



**Richard Fimbres,
Ward Five**



**Steve Kozachik,
Ward Six**

Page intentionally left blank.

ENSURING WATER RELIABILITY TODAY AND IN THE FUTURE



Water Reliability

In fiscal year 2013, Tucson Water launched the **Water Reliability Program**, a series of investments, projects, and commitments that ensure our customers will have a reliable water supply and system now and in the future. The **Water Reliability Program** encompasses five areas: water supply, water quality, water customers, operations and systems, and water conservation and efficiency. Each of these water reliability elements are linked and interdependent.

The **Water Reliability Program** reinforces the Utility's commitments to:

- Deliver safe and high quality water.
- Maximize the use of all local renewable water resources.
- Ongoing maintenance and improvement of our water supply and delivery system.
- Ensure a financially stable utility.
- Provide long-term planning and appropriate infrastructure and program investment.
- Improve energy efficiency throughout the water system.
- Offer clear and timely communication about our water and how to use and re-use it efficiently.

This Annual Report for Fiscal Year 2013 highlights activities around the **Water Reliability Program** and Tucson Water's ongoing focus on delivering on our commitments to customers, employees and the community.

ENSURING WATER RELIABILITY TODAY AND IN THE FUTURE



Tucson Water performs thousands of tests each year on water samples and reports the results to our customers, elected officials, and the Arizona Department of Environmental Quality (ADEQ). The ADEQ is responsible for overseeing and enforcing all EPA Safe Drinking Water Quality regulations in Arizona.

Constructing a New Water Treatment Facility

Construction of Tucson Water's new Advanced Oxidation Process (AOP) Water Treatment Facility started in September 2012. The AOP Facility uses a proven and cost-effective technology – ultraviolet light and hydrogen peroxide – to remove 100% of 1,4-dioxane and other contaminants from drinking water. For maximum efficiency, the new AOP is being constructed adjacent to existing Tucson Airport Remediation Project (TARP) facilities. Together these facilities will treat and purify up to 8 million gallons of water a day. The ADEQ approved final AOP Facility design and will approve construction. The City of Tucson Development Services inspects during construction. The AOP construction also helps to fuel the local economy: 50 local contractors and workers are at the construction site daily. Facility construction is on schedule and within budget, slated for a January 2014 operational date.



Researching for Water Quality Advancements

In fiscal year 2013, Tucson Water continues to participate in collaborative research projects to improve the quality of drinking and reclaimed water for the utility and even the state. As a member of the National Science Foundation at the University of Arizona Water Environment & Technology (WET) Center, Tucson Water is conducting research on instruments that will:

- Improve the speed of and detection of *E. coli*
- Continuously monitor for microbial and bacterial contaminants
- Detect viruses

Tucson Water staff is also part of an advisory panel on emerging contaminants for the ADEQ. This special group of experts is examining the occurrence of unregulated chemical and microbial contaminants in Arizona's water to minimize risk to human health and the environments.



ENSURING WATER RELIABILITY TODAY AND IN THE FUTURE



As an enterprise fund, Tucson Water depends on customers for generating revenue, shaping water rates and fees, offering feedback and helping to drive and develop conservation programs. Utility staff listen to what customers are saying in a multitude of ways: focus groups, emails, public meetings, CWAC, the Unified Community Advisory Board (UCAB), online surveys, phone research, small group presentations, personal visits and more.

More Customers Receive High-Tech Water Meters

Research shows that Tucson Water customers want metering technology that can help them understand and control usage, conserve water and save money on their utility bills. Tucson Water is strategically replacing approximately 25,000 manual read residential and commercial meters per year with new automatic meter reading (AMR) technology that transmits data to a handheld or vehicle-mounted collection unit. In fiscal year 2013 the total of AMR meters in the field is nearly 80,000.



Tucson Water also began a pilot program with Tucson Electric Power to test meters that interface with broadband and smartphones so customers can monitor water usage as it happens. And the Utility's new meter protocol program provides early warning on aging and malfunctioning residential water meters, so fewer customers experience 'bill shock' and less water is wasted.

Customer Support of Water Conservation Makes City a Winner

When thousands of Tucsonans pledged to save nearly 39 million gallons of water and promised to reduce landfill waste by more than 959,000 pounds, Tucson won first place in the 2013 National Mayor's Challenge for Water Conservation – the top spot for residents of similar-sized cities. From April 1-30, 2013, Tucson Water customers pledged online to help the City to achieve the number one spot over Las Vegas, Portland, Atlanta, Tampa, Miami, and other cities in the 300,000 to 599,999 population category.



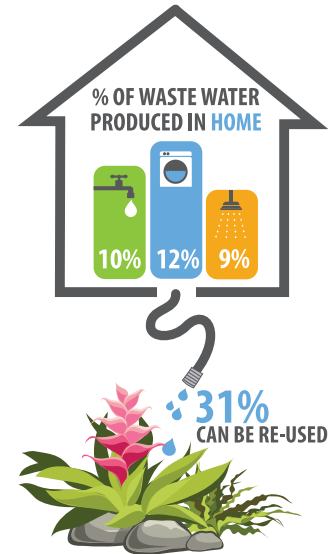
"I am extremely proud of our city for the way Tucsonans stepped up and pledged to do what we already do better than most U.S. cities - conserve our natural resources," said Mayor Jonathan Rothschild.

ENSURING WATER RELIABILITY TODAY AND IN THE FUTURE

Expanding Rebates to Save Water and Money at Home and Work

Tucson Water, in conjunction with CWAC, improved and refined rebate and incentive programs during the fiscal year:

- The Single Family Residential Gray Water Rebate Program increased up to a \$1,000 rebate for qualifying gray water systems installed in homes.
- The Commercial/Industrial High-Efficiency Urinal Rebate Program increased up to a \$500 rebate for WaterSense-certified or water-free urinals installed in businesses. A wider range of urinal models, including waterless urinals, is now included in the rebate.



Water **Supply**

FACT: Tucson Water no longer relies solely on pumping groundwater wells for drinking water. In 2013, the Utility met more than 90% of drinking water demands with a blend of groundwater and Colorado River water delivered via Central Arizona Project (CAP) pipelines to Tucson Water's Clearwater Renewable Resources Facility. Tucson Water is Arizona's largest municipal subcontractor of Colorado River water.

Recharging One Million Acre Feet of Water.... and Counting

In March 2013, the community gathered at Tucson Water's Clearwater Facility to celebrate a milestone: the one millionth acre foot of Colorado River water delivered via CAP pipelines to Clearwater to be recharged, recovered and delivered to customers. Tucson Water recharges 47 billion gallons of water annually, while accessing 25 billion gallons for use – with 22 billion gallons of water in the aquifer for future use.



ENSURING WATER RELIABILITY TODAY AND IN THE FUTURE

Expanding Capacity and Redundancy of Renewable Supplies

Tucson Water substantially completed construction of a \$12 million reservoir and booster station at the Clearwater Renewable Resource Facility during fiscal year 2013, increasing the Utility's capacity to store and deliver CAP water. Preliminary work on a \$28 million, 48-inch pipeline designed to provide redundancy for delivery of recovered groundwater also started in fiscal year 2013.

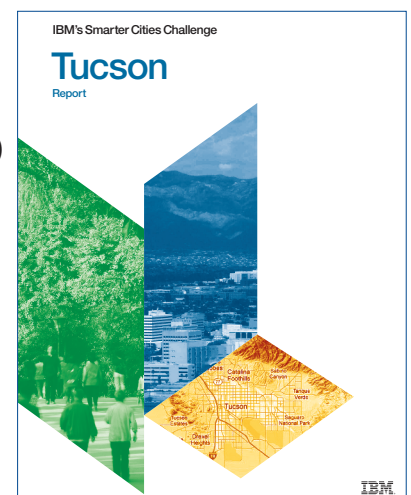


Resource conservation and efficiency is a two-way street: Tucson Water asks customers to use water wisely and customers demand that the Utility actively pursue efficiencies: eliminating leaks, reducing energy consumption, maintaining equipment and infrastructure, and seeking cost savings, to name a few.

IBM Grant Helps Utility Identify Efficiencies

Tucson was one of 100 cities around the world selected by IBM to participate in its Smarter Cities Challenge (SCC). From February 25, 2013 to March 15, 2013 a team of handpicked IBM executives provided City of Tucson leaders and Tucson Water staff with *pro bono* consulting valued at \$400,000. In May 2013, the IBM SCC team presented their recommendations to Tucson Water:

1. Work to provide real-time data to Customer Service Representatives and customers.
2. Implement an Automatic Metering Infrastructure (AMI) pilot project and accelerate AMI system deployment.
3. Lower energy costs and reduce water loss through optimizing water control systems: refresh the Supervisory Control and Data Acquisition (SCADA) system with additional metering, and optimize analytics, continuous water balancing strategies and data integration.
4. Develop an information technology master plan to enable data-driven management.



The benefits of the SCC Grant: Tucson Water staff received an external, objective, and systematic evaluation of the Utility's long range plans, technology, projects and service. The Utility immediately started to implement SCC recommendations.

ENSURING WATER RELIABILITY TODAY AND IN THE FUTURE

Launching a Year-Round Conservation and Efficiency Program

In fiscal year 2013, Tucson Water launched the new WaterSmart Program, which asks customers to “Do Your Part. Be Water Smart” every day of the year. The WaterSmart Program groups all of the Utility’s conservation efforts– educational programs, assistance and incentives – under one umbrella:

- Free WaterSmart Classes
- Rainwater Harvesting Rebates
- Gray Water System Rebates
- High Efficiency Toilet (HET) Rebates
- HET Replacement for Low Income Homeowners
- Irrigation System Rebates
- Water Waste Enforcement
- The Zanjero Home Water Audit Program
- Student and Teacher Education Programs
- SmartScape Training for Green Industry Professionals
- WaterSmart Business Certification Program
- Free brochures, booklets, how-to videos, and more are available online and upon request



Being ‘water smart’ has many benefits for both the customer and Tucson Water: saving natural, reducing expenses, improving efficiency, lowering utility bills, and helping to create a more sustainable community.

Pursuing Tangible Energy Efficiencies

It requires a substantial amount of energy to operate a water utility, one reason why Tucson Water’s Energy Team explores energy alternatives and resource efficiencies. In fiscal year 2011, Tucson Water received funding awarded to the City under an American Recovery and Reinvestment Act (ARRA) Energy Efficiency and Conservation Block Grant to improve the efficiency of water distribution system pumps, which consume 30% of the energy to run the water system. Tucson Water upgraded, reconditioned and replaced pumps and motors at approximately 15 booster station sites. In fiscal year 2013, the Block Grant pilot test was complete with positive results – projected savings of 615,000-kilowatt hours of electricity and \$52,000. In the future: look at upgrading and rehabilitating 85 other booster station sites for more savings.



ENSURING WATER RELIABILITY TODAY AND IN THE FUTURE



The Tucson Water system is one of the nation's largest and most complex, representing more than \$1 billion in assets. It's an investment that needs constant monitoring, maintenance and improvement as infrastructure ages, technology evolves, and our population grows. Utility employees are working 24/7 to ensure our operations and systems are in top-notch condition, delivering clean and safe water when a customer turns on the tap.

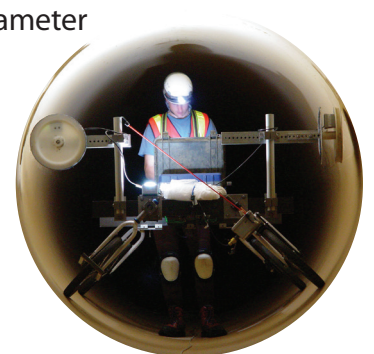
Replacing and Improving Delivery Infrastructure

Tucson Water replaced \$5.5 million in aging pipeline as part of scheduled road improvements and \$1.5 million in several neighborhoods. Tucson Water, along with other public and private utilities and communications companies, was heavily involved with \$19 million in infrastructure improvements related to the Sun Link Streetcar project – the City's largest construction project in its history. Utility staff, working with contractors, helped to relocate, replace and inspect pipes, meters, fire hydrants, mains and more along the 3.9-mile streetcar corridor.



Pipeline Protection Program Proves Its Value

Tucson Water is a world leader in 'smart' technology for large diameter pipeline, the backbone of our water delivery system. Tucson Water's Pipeline Protection Program is recognized as one of the most advanced and successful working programs in the world to prevent pipeline failure. The Program allows staff to quickly and easily detect and repair large pipeline, which means that critical large diameter pipe is kept in top working condition for 50 plus years.



In August 2012, the system detected and prevented a major 96" pipeline failure – which would have resulted in millions of gallons of water loss and months of repair.

ENSURING WATER RELIABILITY TODAY AND IN THE FUTURE

Rehabbing Three Reservoirs that Equal 40 MG of Storage

The Utility's 63 reclaimed and drinking storage facilities represent 321 millions of gallons of available storage and \$200+ million in assets. During fiscal year 2013, year two of the Tucson Water's long range Reservoir Rehabilitation Program, the team completed rehabilitation of three potable reservoirs: Paseo Tamayo, Wilmot, and Craycroft Reservoirs. Together these three reservoirs store almost 40 million gallons of drinking water, helping to ensure reliable water supplies and service.





FINANCIAL SECTION

Page intentionally left blank.



CliftonLarsonAllen

CliftonLarsonAllen LLP
www.CLAconnect.com

INDEPENDENT AUDITORS' REPORT

Honorable Mayor and Members of the City Council
City of Tucson, Arizona

Report on the Financial Statements

We have audited the accompanying financial statements of Tucson Water, an enterprise fund of the City of Tucson, Arizona (the "City"), which comprise the statement of net position as of June 30, 2013, and the related statement of revenues, expenses and change in net position and cash flows for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Tucson Water, an enterprise fund of the City of Tucson, Arizona, as of June 30, 2013, and the changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of a Matter

Change in Accounting Principle

As discussed in Note 15 to the financial statements, in 2013 the City adopted GASB Statement No 65 (Items previously Reported as Assets and Liabilities). Our opinion is not modified with respect to these matters.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 13 through 30 is presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

The introductory section and supplementary information listed in the table of contents have not been subjected to the auditing procedures applied in the audit of the financial statements, and accordingly, we do not express an opinion or provide any assurance on them.

CliftonLarsonAllen LLP

Tucson, Arizona
August 22, 2014

MANAGEMENT'S DISCUSSION AND ANALYSIS

Introduction

The Management's Discussion and Analysis (MD&A) section of the Tucson Water Annual Report presents discussion and analysis about the financial performance of Tucson Water (the Utility) during the fiscal year ended on June 30, 2013 (fiscal year 2013). The MD&A focuses on significant financial issues, provides an overview of the Utility's financial activity, and provides descriptions of significant asset and debt activity.

Potable Customer Connections	Potable Peak Day Demand	Potable Average Day Demand	Miles of Potable Pipeline	Potable Storage Capacity	Fiscal Year 2013 Potable Sales	Fiscal Year 2013 Potable Sales
228,102	131.7 MGD	94.1 MGD	4,500	268 MGD	\$136.3 M	92,900 AF (40.5 million Ccf)

Overview

Tucson Water is an enterprise fund of the City of Tucson, Arizona (the City). This means we operate similar to a private business, covering all the costs of doing business with revenues from operations. Our fiscal year runs from July 1 through June 30. Our authority and responsibility is derived from the City's Charter and ordinances and resolutions of the Mayor and Council. We provide water service to approximately 713,000 people (about 72% of the greater Tucson metropolitan area's total population) within a 300 square-mile service area that lies within Pima County. We ended fiscal year 2013 with over 228,000 customer connections to our water system, and during the year delivered approximately 92,900 acre-feet (30.3 billion gallons of potable water) or approximately enough potable water to fill over 1.9 million residential swimming pools. Additionally, we delivered 5.1 billion gallons of reclaimed water for turf irrigation.

Operations

Potable Water

During fiscal year 2013 Tucson Water obtained its municipal potable water – water meeting or exceeding all federal, state, and local drinking water standards – from two sources:

- four groundwater well fields (Central, Avra Valley, Santa Cruz, and Southside)
- facilities where the Utility recharges and recovers Colorado River water.

Units of measure	
1 acre foot	1 Ccf
325,851 gallons	748 gallons

These four well fields and the recharge and recovery facility provide us with an aggregate production capacity of 657 acre-feet (214 million gallons) per day.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Our surface water source contract with the United States Department of the Interior and the Central Arizona Water Conservation District (CAWCD) provides us access to 144,172 acre-feet annually of Colorado River water, delivered via the Central Arizona Project (CAP). The CAP consists of 335 miles of waterworks and associated facilities designed to deliver water from Lake Havasu on the Colorado River to Maricopa, Pinal, and Pima Counties in central/southern Arizona.

In fiscal year 2013, our Clearwater Renewable Resource Facility (CRRF), a facility/system used to recharge, recover, and distribute CAP water, pumped 71,712 acre-feet of blended recharged/recovered CAP water and groundwater into our distribution system. CRRF, constructed northwest of the City of Tucson, is composed of recharge basins, recovery well fields, storage, and transmission facilities. The facility, with a current capital investment of \$244 million, permits the recharge annually of our entire 144,172 acre-foot allocation of Colorado River water, an important renewable source. Current recovery well capacity is 103,950 acre-feet annually. We have been recharging annually more Colorado River water than our customers' water demand. This enables us to nearly eliminate groundwater pumped from the central well field over which the majority of the City of Tucson lies, thereby easing concerns related to land subsidence and enabling us to store water for future use.

Operations

Reclaimed Water

Recycled water is an important water resource. The Utility uses some of its recycled water to produce reclaimed water, which is specially treated for applications such as irrigation, dust control, fire fighting, and industrial uses. Reclaimed water is excellent for the irrigation of turf, ornamental landscaping, food crops, orchards, and vineyards as the nitrogen and phosphorus in the water provide fertilizer for plants and grass.

Although only 6.8% of our total fiscal year 2013 water sales revenue and 15% of water sales volume, reclaimed water is playing an increasingly important role in meeting our current and future water demands. Tucson Water has the right to use more than half of the effluent produced at the metropolitan wastewater treatment facilities owned and operated by Pima County. Planning for the reclaimed water system was initiated in 1982 and we began delivering reclaimed water to customers for turf irrigation in 1984. The reclaimed water Tucson Water provides to our customers is, like all of the water we deliver, regulated by the Arizona Department of Environmental Quality (ADEQ). The reclaimed water delivered by Tucson Water is rated as Class A by ADEQ.

Our reclaimed system currently includes:

- a treatment plant which filters secondary effluent,
- a wetlands which biologically treats the backwash water from the filtration plant,

MANAGEMENT'S DISCUSSION AND ANALYSIS

- constructed basins for the recharge of secondary effluent with wells to recover this recharged water, and
- a managed in-channel recharge and recovery project recovering, via wells, some of the effluent that has been discharged by the Pima County Wastewater treatment plants into the nearby Santa Cruz River.

This recovered water is blended with water produced at our filtration plant or distributed directly to customers throughout the reclaimed system. Additionally, we receive reclaimed water from a Pima County-operated wastewater treatment plant located mid-town. This facility generates up to 3 million gallons per day reclaimed water which is piped directly into our reclaimed water system. We continue to work to bring additional customers onto the reclaimed water system, thereby transferring their demand from potable to reclaimed water.

Discussion of Basic Financial Statements

We report our financial results in this report on the accrual basis of accounting, in conformance with all applicable accounting principles generally accepted in the United States. Our annual financial reporting includes three basic financial statements (and accompanying notes) and supplemental information.

Statement/Schedule	Description/Purpose
Statement of Net Position	A summary at year end of our current and long-term obligations and our assets available to meet those obligations. The residual of all elements presented (assets plus deferred outflows, less liabilities and deferred inflows) equals net position.
Statement of Revenues, Expenses and Changes in Net Position	A summary of revenues, and operating and non-operating expenses, and the resulting change in net position.
Statement of Cash Flows	A summary of our cash sources, including proceeds from the sale of water revenue bonds, and our use of cash.
Notes to the Financial Statements	The accompanying notes provide additional information essential to understanding the data provided in the basic financial statements.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Financial Highlights/Condensed Financial Statements

Net Position: At June 30, 2013 our total assets and deferred outflows exceeded our total liabilities and deferred inflows by \$789.9 million, an increase from fiscal year 2012 of \$27.8 million. Of this amount, \$30 million was restricted for debt service. At June 30, 2013 net investment in capital assets was \$718.5 million, and outstanding long-term debt of \$518.9 million.

Tucson Water
Summarized Statements of Net Position as of June 30*
(\$ in thousands)

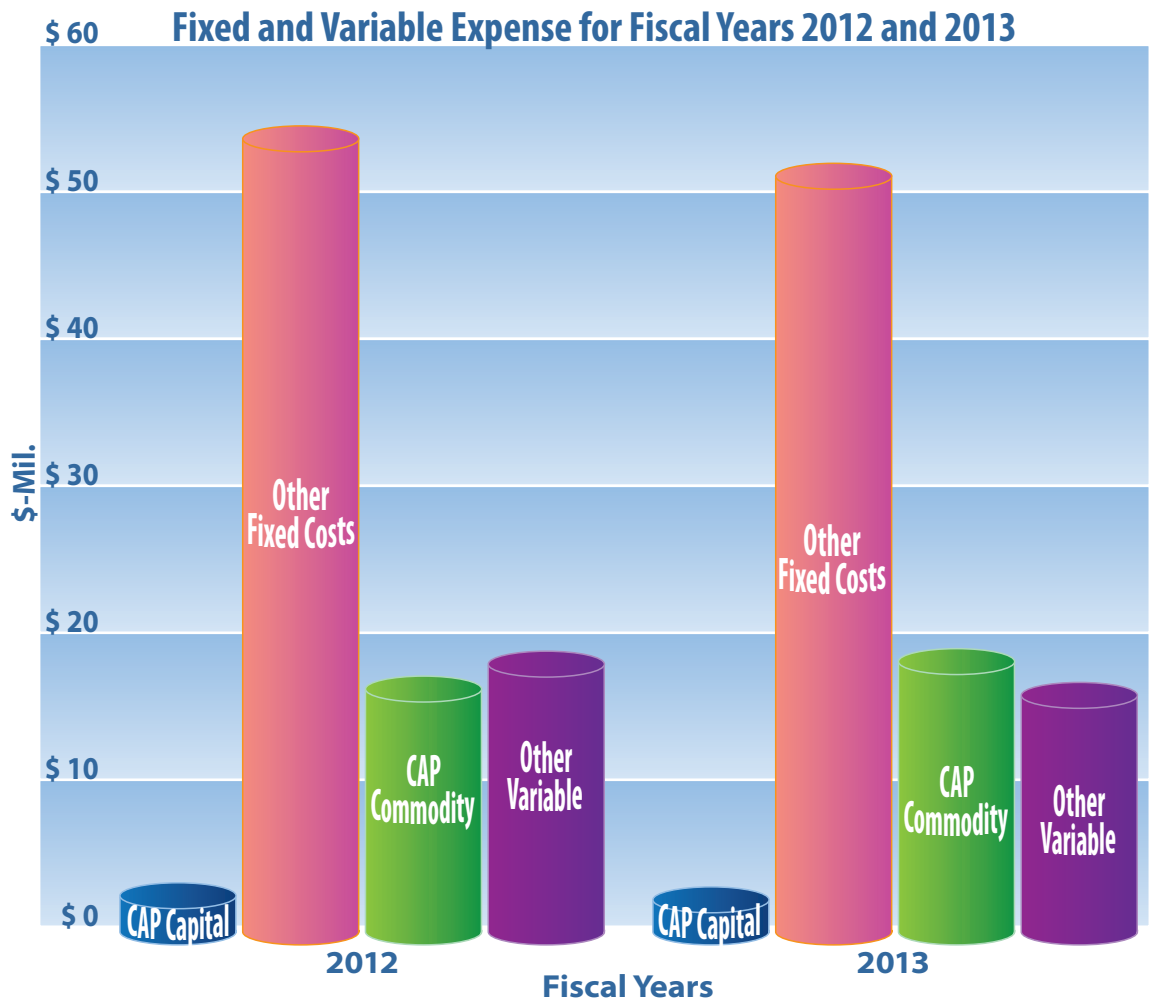
	2013	2012
Current assets	\$ 64,627	\$ 57,034
Restricted assets	55,888	71,360
Long term accounts receivable	452	354
Capital assets, net of depreciation	1,242,531	1,197,039
Loss on refunding of debt	14,392	10,353
Total assets and deferred outflows	1,377,890	1,336,140
Current liabilities	32,325	31,378
Liabilities from restricted assets	33,909	33,678
Long-term liabilities	521,719	508,986
Unavailable revenue	62	38
Total liabilities and deferred inflows	588,015	574,080
Net position		
Invested in capital assets, net of related debt	718,490	700,566
Restricted	29,962	28,097
Unrestricted	41,423	33,397
Total net position	\$789,875	\$762,060

* The net position for fiscal year 2012 is restated. See Note 15 "New Governmental Accounting Standards Board (GASB) Pronouncements."

Operating Revenues: Potable and reclaimed water sales revenues, including the Central Arizona Project (CAP) charge and the Conservation Program fee, make up approximately 93% of the Utility's operating revenues. During fiscal year 2013, these water sales revenues were \$148.4 million and water sales volume totaled 46.9 million Ccfs or about \$8.0 million more in revenue than fiscal year 2012, but delivering about 1.2 million less Ccfs. Total operating revenues increased by \$7.2 million. Central Arizona Project (CAP) charge rates were restructured in fiscal year 2013 to fully recover the cost of CAP water purchases, which resulted in an increase of CAP charge revenue of \$12.1 million. This was offset by a decrease in metered water sales (potable water) of \$4.1 million. The decrease in metered sales revenue is a result of slightly decreased rates established in fiscal year 2013 for the first tier of volume usage.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Operating Expenses: The majority of our operating costs are fixed. In fiscal year 2013, approximately 60% of our annual operating expenses did not vary as a result of the quantity of water we sold. Staff-related expenses (\$32,444), payments to the City of Tucson for administrative support (\$8,320), and CAP capital payments (\$2,163) are our most significant fixed items. The remaining 40% of our operating expenses are made up of expenses that vary with the quantity of water produced or stored. The purchase of CAP water (\$18,094) is over 49% of variable costs. In addition to CAP water purchases, other significant costs that vary with the quantity of water produced or stored are power (electricity and natural gas) and chemicals. Other expenses are discretionary in nature; for example, community relations, training, consultant, or membership costs.



Excluding the slight increase in depreciation, fiscal year 2013 operating costs were \$1.5 million higher than fiscal year 2012 operating costs. Employee costs remained flat from fiscal year 2012 to fiscal year 2013. Notable changes in other operating costs include:

- The low-flow toilet rebate program increased by \$.6 million.

MANAGEMENT'S DISCUSSION AND ANALYSIS

- The Utility purchased 144,172 acre feet of CAP water at an additional commodity cost of \$1.9 million over fiscal year 2012.
- Contractual services under Water Operations increased \$1.4 million, mostly due to increased consulting and planning services for the Supervisory Control and Data Acquisition (SCADA) project due to be completed in fiscal year 2019.
- Increased costs were partially offset by a decrease of \$.9 million in power costs for potable system wells.

Additionally, non-operating expenses decreased \$3.3 million, primarily due a decrease in bond interest expense as a result of cost savings on refunded debt, and an increase of the amount of interest capitalized on bond projects.

Tucson Water
Summarized Statements of Revenues, Expenses and Changes in Net Position
Fiscal Years Ending June 30
(\$ in thousands)

	2013	2012
Operating revenues:		
Water sales	\$ 131,182	\$ 135,278
Other revenues (including CAP charge)	27,815	16,532
Total operating revenues	158,997	151,810
Operating expenses	121,052	118,793
Net operating income	37,945	33,017
Non-operating income	1,676	1,716
Non-operating expenses	18,368	21,671
Net Income before capital contributions/ adjustments	21,253	13,062
Capital contributions	8,162	10,189
Net transfers out	(1,600)	(1,600)
Change in net position	\$ 27,815	\$ 21,651

MANAGEMENT'S DISCUSSION AND ANALYSIS

Financial Highlights/Condensed Financial Statements

The remainder of this MD&A provides a look into our fiscal year 2013 revenues, operating expenses, capital outlays, debt service, changes in net position, and cash flows.

Fiscal Year 2013 and Fiscal Year 2012 Comparisons (\$ in thousands)

	2013 Actual	2012 Actual
Total water sales revenue⁽¹⁾	\$ 148,419	\$ 140,430
Potable	139,123	131,100
Reclaimed	9,296	9,330
Other revenue⁽²⁾	12,254	13,100
Total water sales (Ccf)⁽³⁾	46,943,564	48,133,965
Potable	40,460,196	41,433,136
Reclaimed	6,483,368	6,700,829
Average monthly water service connections⁽³⁾	229,194	229,335
Potable metered	224,283	224,426
Fire protection	3,819	3,819
Reclaimed metered	1,092	1,090
Potable water 12-month average use per svc per month (Ccf)	14.59	14.58
Single family customers only	9.1	9.6
Total additions: potable metered service connections⁽⁴⁾	1,186	1,386

(1) Total water sales revenue includes revenue generated by usage rates, fixed monthly charges based on meter size, and special surcharges based on water usage.

(2) Other Revenue consists of other operating revenues and non-operating income from the financial statements. Other Revenue does not include system equity or water resource fees received (\$3.2 million and \$2.7 million in fiscal year 2013 and 2012, respectively). These fees are recorded on the financial statements as capital contributions.

(3) 1 Ccf = 748 gallons. Monthly average connections for the 12 months of the Fiscal Year.

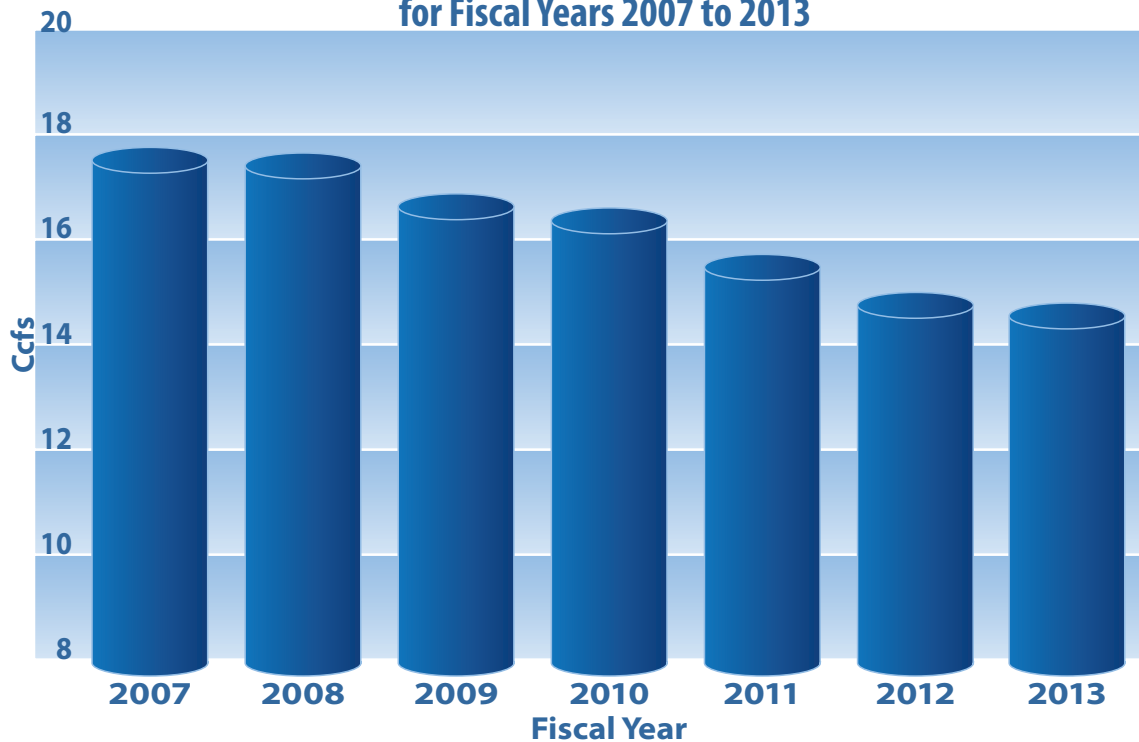
(4) Change in year's average potable metered connections.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Potable Water – Sales and Volume

Fiscal year 2013 potable water sales volume (40.5 million Ccfs or 30.3 billion gallons) is a 2.3% decrease over the fiscal year 2012 volume. This continues a multi-year term trend of declining water consumption by the community. Potable water revenues did, however, increase as a result of the water rate increase effective in July 2012. Included in potable revenue is the CAP charge, which increased from \$.05 per Ccf in fiscal year 2012 to \$.38 per Ccf in fiscal year 2013.

**Potable Water – Average Monthly Use/Service
for Fiscal Years 2007 to 2013**



Both water sales volume and water sales revenues are influenced by many factors: for example, metered connection growth; weather; plumbing codes encouraging or enforcing low water use fixtures and appliances in new construction; new single family homes having less acreage than in the past; landscaping codes encouraging low water use plants; on-going conservation programs emphasizing education and behavioral changes; our conservation-oriented rate structure; and perhaps most importantly, overall community economic conditions.

Growth in metered connections always pulls revenues in a positive direction, due to any additional volume of water provided to the new connection as well as the monthly service charge assessed to each account regardless of the amount of water used. Fiscal year 2013 growth in average metered service connections (1,186 or .5%) was a slight improvement over fiscal year 2012, but continued to reflect the slowly recovering housing industry within our service area.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Reclaimed Water – Sales and Volume

When compared to fiscal year 2012, reclaimed water sales volume in Ccfs decreased 3.2% while revenue remained virtually flat, due to a July 2012 rate increase to the reclaimed contract usage. The 217,461 decrease in Ccfs was largely the result of decreased reclaimed consumption by local golf courses.

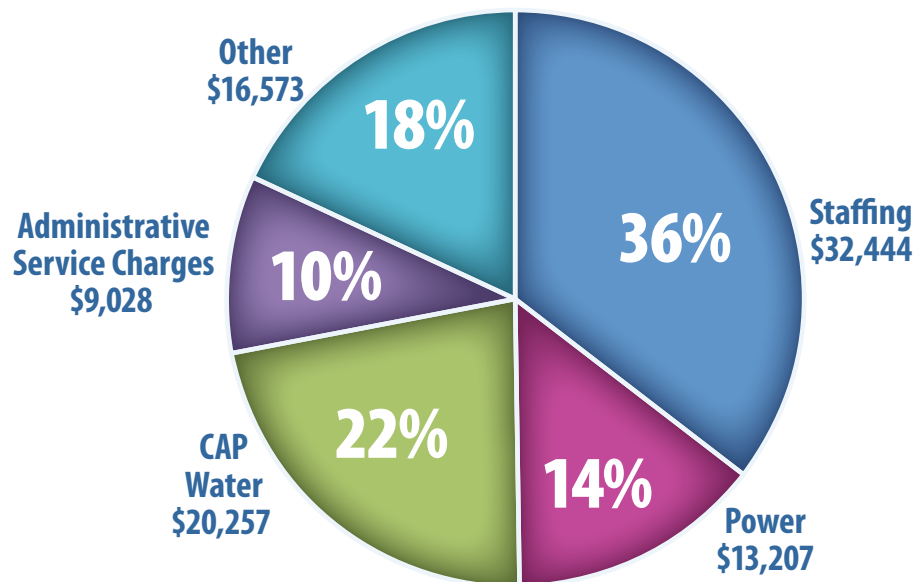
Revenue Outlook: Next Five Years

The Utility is challenged by the decline in consumption per service and the slow increase in new connections. To be conservative in its financial planning, the Utility has assumed a continuing decline in consumption for the next five years. Likewise, the projected number of new connections included in planning is also at a conservative level of approximately 1,000 per year, which is well below the 4,000-6,000 levels experienced before the economic downturn.

Operating Expenses

We expend considerable financial resources to operate our two water systems (potable and reclaimed). We incurred \$91.5 million in operating expenses in fiscal year 2013 (excluding depreciation of \$29.5 million) or about \$399 per service account, a 1.6% increase over fiscal year 2012. While we are a large utility with many varied expenses, four cost categories made up 82% of the \$91.5 million operating costs: employee costs, power costs, CAP water costs, and administrative service charges.

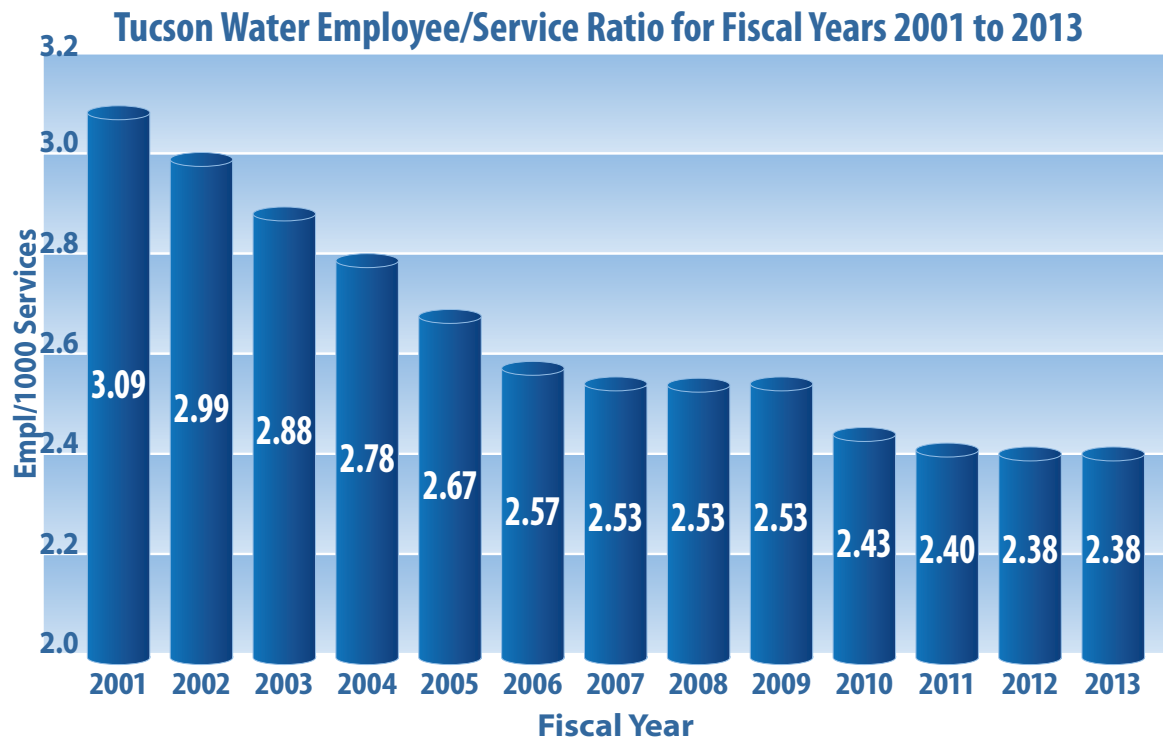
Fiscal Year 2013 Operating Expenses – \$91.5 Million



MANAGEMENT'S DISCUSSION AND ANALYSIS

Employee costs relate to our diverse staff of 549 budgeted employees, reflecting a slight decrease in the number of positions from fiscal year 2012. Employee costs remained flat at \$32.4 million in both fiscal year 2013 and fiscal year 2012. Our employees serve in varying roles: planning for our community's growing water resource needs; ensuring the quality of the water we deliver; designing storage and delivery systems to meet our customer demands; providing proper maintenance to all elements of our system; and providing customer service through accurate meter reading and billing.

As a result of the monitoring of meter reading routes, flexible work hours, and increased use of technology and automation, the Utility has been able to reduce the employee per-service ratio. There was no decrease in this ratio during fiscal year 2013 and the staffing levels are expected to rise modestly in the coming years as a result of elevated maintenance and replacement costs.



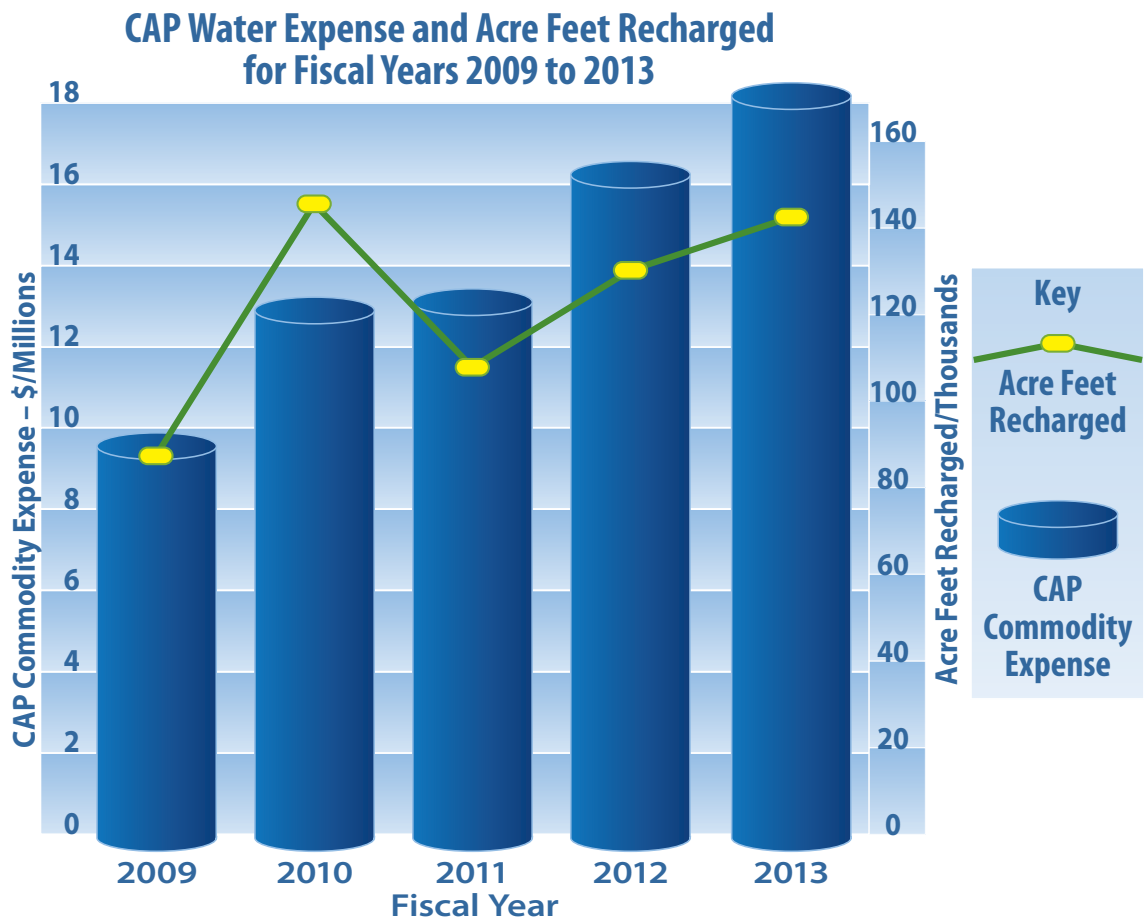
Power costs are incurred as we pump groundwater up from depths up to 700 feet and move it through our distribution system. Recharged CAP water is recovered and moved from the facilities approximately 20 miles outside of our central service area. This facility has significantly offset the numerous central well field wells that previously pumped and delivered groundwater. To control power costs, we have converted, where feasible, to less expensive, interruptible rates and have designed our system to operate with a mix of electric and natural gas powered pumps. During fiscal year 2013, Tucson Water had 217 active, potable water producing wells, of which 180 (83%) were electric powered and 37 (17%) were natural gas powered.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Power costs were approximately \$13.2 million in fiscal year 2013 and \$14.2 million in fiscal year 2012. The decreased cost of \$1.0 million was partially the result of the 2.5% decrease in water sales volume (less water moved through our distribution systems); however, the main contributor was a decrease in the rates for our natural gas powered wells.

CAP water costs (\$20.3 million in fiscal year 2013 and \$18.4 million in fiscal year 2012) are incurred from our purchase of Colorado River water from the CAWCD. Our fiscal year 2013 CAP water costs consisted of two components:

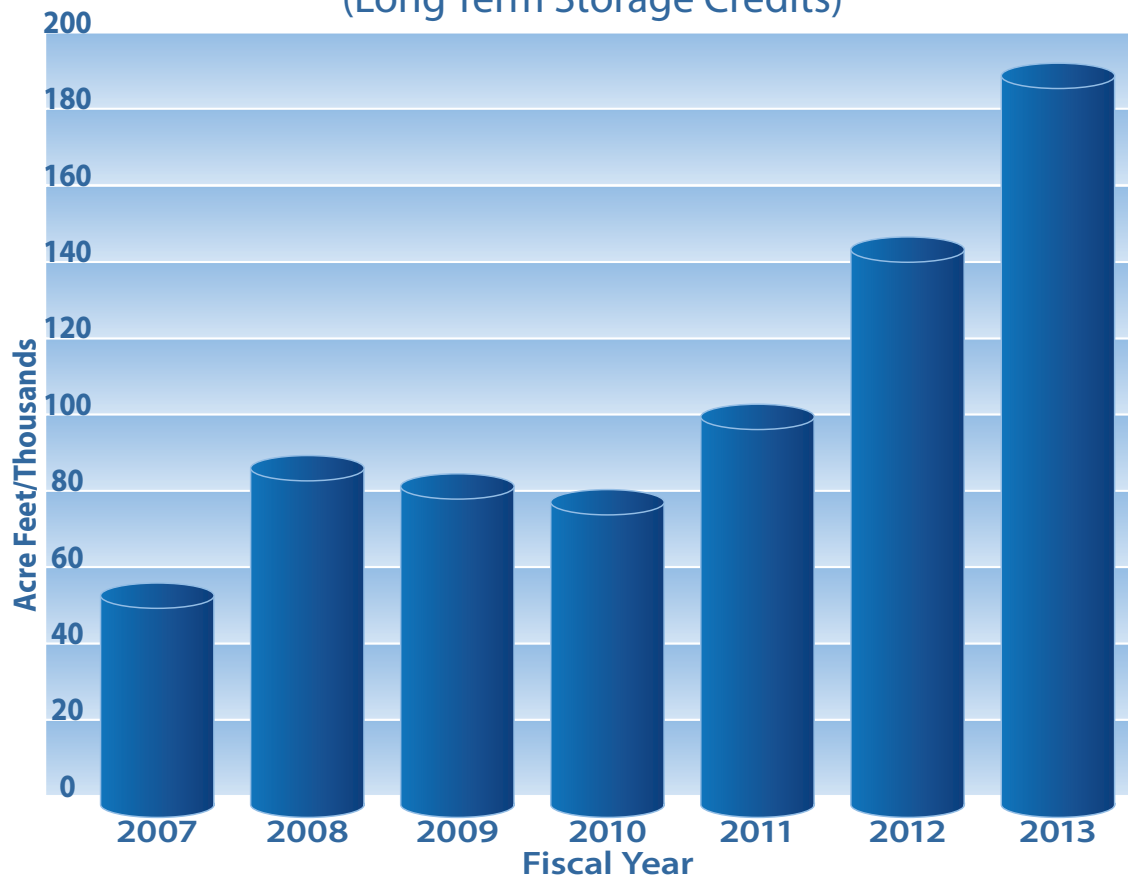
- The capital financing charge, \$2.2 million in both fiscal year 2013 and fiscal year 2012, is based on the Utility's annual allotment of 144,172 acre-feet and charged regardless of the amount of CAP water purchased each year.
- The commodity charge (\$18.1 million and \$16.2 million in fiscal year 2013 and fiscal year 2012, respectively) is based on the actual amount of CAP water taken. During fiscal year 2013, the Utility purchased the full 144,172 acre-feet of CAP water allotted to the City of Tucson. The increase in the commodity charge reflects the additional 13,385 acre-feet purchased over fiscal year 2012 as well as a 5.7% increase in the commodity cost per acre-foot charged by CAWCD.



MANAGEMENT'S DISCUSSION AND ANALYSIS

By purchasing and recharging approximately 50,400 AF more CAP water than we delivered, we are banking this water for future use by our customers. This banking of water increases our systems future reliability should CAP water shortages occur in the future. As of December 2013, Tucson Water had stored enough CAP water to meet nearly 175% of our fiscal year 2013 potable demand.

Cumulative CAP Water Stored – Calendar Year End December 31 Totals (Long Term Storage Credits)



Administrative service charges, \$9.0 million in fiscal year 2013 and \$9.2 million in fiscal year 2012, are the payments to the City of Tucson for support services (procurement, payroll, budget, etc.). All payments are for direct services or indirect administrative support. No Utility funds are transferred to the City to support non-Utility related purposes.

Operating Expenses Outlook: Next Five Years

Managing our operational expenses continues to be a significant focus for the Utility. Operating expenses are anticipated to increase significantly over the next five years, largely due to increased cost for CAP water. Payments for CAP water are expected to increase approximately 49% over the next five years based on projections provided by CAWCD. Additional operational cost pressures include the potential for continued

MANAGEMENT'S DISCUSSION AND ANALYSIS

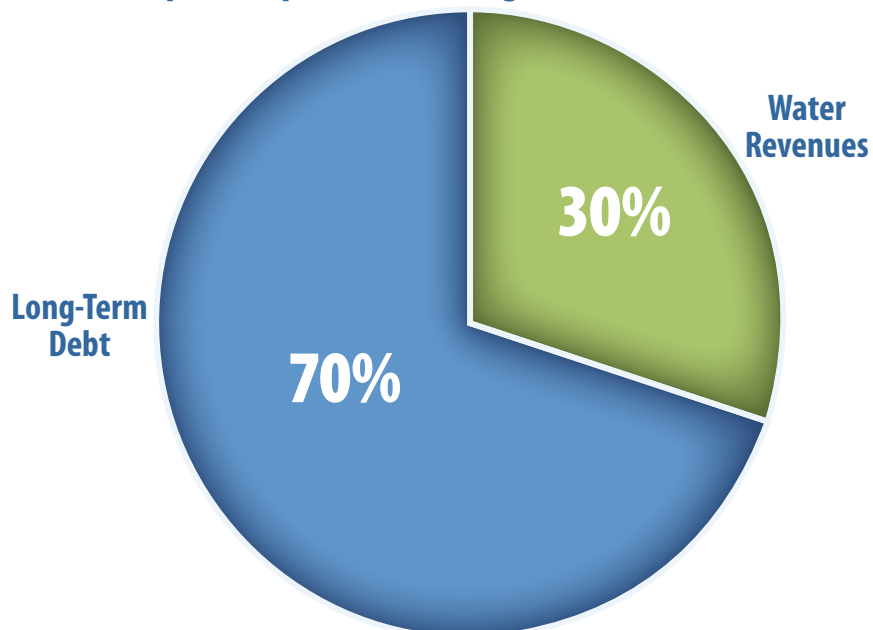
volatility in power costs, increasing employee related costs, particularly those related to pension and health care, and increases associated with funding of our capital program (both pay-as-you-go and principal/interest debt service payments). We will continue to identify operational efficiencies enabling us to provide potable and reclaimed water while maintaining water rate adjustments at levels acceptable to the community we serve.

Capital Improvements

Tucson Water plans, designs, and constructs improvements to the water system infrastructure to meet the demands of current and future customers. The capital improvement program (CIP) is focused on the utilization of our long-term renewable water resources. At the end of fiscal year 2013, our water system was composed of 221 active water producing wells, approximately 4,500 miles of delivery pipelines, 117 boosters to move water around our delivery area, and 65 reservoirs (57 potable and 8 reclaimed) to store water to meet peak demands.

We fund our capital program with a combination of current revenues (pay-as-you-go cash from the sale of water to our customers) and long-term debt/bond proceeds (cash from the sale of revenue bonds/obligations). This funding practice enables both current and future customers to participate in the funding of capital improvements.

**Funding of Fiscal Year 2013
Capital Improvement Program – \$69.5 Million**



MANAGEMENT'S DISCUSSION AND ANALYSIS

During fiscal year 2013, the Utility spent approximately \$69.5 million on improvements to the system compared with fiscal year 2012 spending of \$53.0 million. Eleven projects accounted for 62% (\$43.3 million) of fiscal year 2013 CIP spending:

- Three projects (reservoir/booster, main interconnect improvements, collector lines, equip wells) pertaining to our Clearwater recharge and recovery facility accounted for \$14.5 million
- Water main replacements associated with road improvements in our community accounted for \$11.2 million of which \$4.7 million expenditures associated with the Sun Link Tucson Streetcar
- Our ongoing potable water meter replacement and reservoir/tank rehabilitation programs utilized \$3.6 million and \$2.7 million, respectively
- \$9.7 million was spent on the continuing construction of a state-of-the-art facility to remove 1,4-dioxane from groundwater recovered within a section of the south side well field
- \$1.6 million for the construction of the Regional Reclaimed Facility

In accordance with accounting standards, we allocate a portion of our overall administrative costs to our CIP and capitalize interest expense. The fiscal year 2013 total for both of these allocations was \$10.8 million.

The remaining \$15.3 million of fiscal year 2013 CIP spending occurred on over 100 capital projects.

Capital Expenditure Outlook: Next Five Years

The Five-Year CIP Plan is the infrastructure foundation of our water supply strategy for the community. Over the next five years, we plan to spend approximately \$324.0 million to fund important capital projects. \$310.4 million will be spent on the Potable Water System. Our emphasis will be \$72.0 million in improvements and expansion of Tucson Water's Clearwater Renewable Resource Facility, including recovery mains, transmission mains and collector lines. The capital program will also focus on our overall system replacement and rehabilitation needs and includes \$22.9 million for water line relocations or replacements associated with road projects, \$15.1 million for main replacements, \$32.6 million for meter replacements, \$25.1 million to preserve the integrity of the Utility's storage facilities by making necessary improvements to reservoirs, \$4.9 million for the Advanced Oxidation Treatment Plant and \$18.4 million for improvements to our water system control and communications systems. The Reclaimed Water System projects total \$28.8 million which includes the construction of the Regional Reclaimed Facility, pumps, boosters and the drilling and equipping of new reclaimed wells. The five-year plan also includes \$7.7 million for a reclaimed water enhancement project that will be jointly funded by Tucson Water and Pima County.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Debt and Debt Service

At June 30, 2013, the Utility had \$518.1 million in outstanding water revenue bonds and obligations. Water revenue bond interest expense on this debt (\$16.8 million in fiscal year 2013) is reported as a non-operating expense on our income statement. Repayment of principal (\$24.5 million in fiscal year 2013) is reported only on our flow of funds statement. In addition, \$1.4 million in fiscal agent fees was paid during the year.

During fiscal year 2013, the following bond sales or loans agreements occurred:

Amount	Interest Rate	Month
\$ 53.1 million senior lien refunding	.614-5.0%	May 2013
\$ 21.1 million senior lien obligation	1.5 – 5.0%	June 2013

Cash receipts generated from the System Equity (buy-in) fee are dedicated to payment of the annual requirements for debt service.

	FY 2013	FY 2012
System equity fee collections	\$2.6 million	\$2.4 million
Water revenue bond/obligations debt service	\$42.5 million	\$41.3 million
System equity fee as % of debt service	6%	6%

The financing of our capital program with a combination of bond proceeds/loans and water sales revenues, generates a healthy ratio of outstanding water revenue bond debt to system fixed assets.

Ratio of Outstanding Water Revenue Bonds to Capital Assets⁽¹⁾ Fiscal Years Ending June 30 (\$ in millions)

	FY 2013	FY 2012
Land	\$49.3	\$49.3
Buildings	109.6	101.6
Water mains	1,316.3	1,276.8
Construction in progress	132.7	106.2
Machinery	42.6	41.8
Goodwill	1.1	1.1
Water rights	52.1	52.1
Less accumulated depreciation	(461.2)	(431.9)
Total capital assets	\$1,242.5	\$1,197.0
Water revenue bonds/obligations outstanding	518.1	511.6
Ratio water revenue bonds/capital assets	0.42	0.43

(1) Goodwill and capitalized water rights not included

MANAGEMENT'S DISCUSSION AND ANALYSIS

Change in Net Position

The change in net position is the amount by which our revenues and capital contributions exceed our expenses, including depreciation. The change in net position for fiscal year 2013 was \$27.8 million or \$6.1 million more than the fiscal year 2012 increase.

Change In Increase to Net Position – Fiscal Year 2013 from Fiscal Year 2012 (\$ in millions)

Increase to net position fiscal year 2013	\$27.8
Increase to net position fiscal year 2012	21.7
Change in amount of increase	6.1

Detail of Changes - fiscal year 2013 from fiscal year 2012

Revenues	
Increase in water sale (potable and reclaimed)	\$8.0
Decrease in other revenues	(0.9)
Increase in revenues	\$7.1
Expenses	
Increase in depreciation expense	(\$0.8)
Decrease in power expense	0.9
Increase in employee costs	-
Decrease in debt service interest	3.3
Increase in CAP water costs (capital and commodity)	(1.8)
Increase in contractual services	(1.2)
Decrease in operation commodities	0.6
Increase in other expenses	-
Decrease in expenses	\$1.0
Capital contributions	
Decrease in capital contributions	(2.0)
Change in Increase to net position – FY 2013 from FY 2012	\$6.1

Since the Utility operates as a self-supporting utility of the City of Tucson, we must receive adequate cash (from revenues) during the year to support our operating and capital improvement cash requirements. In addition, we must meet financial policies governing *cash reserve balances* and *debt service coverage*. For this reason, we focus more on our projected and *actual flow of funds* than on *change in net position*.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Cash Reserves – During April 2013, the Mayor and Council adopted a Financial Plan targeting cash reserve levels at approximately \$25.7 million by the end of fiscal year 2013. At June 30, 2013, unrestricted/undesignated cash on hand was \$33.1 million.

Debt Service Coverage (the % by which revenues, after meeting operating cash needs, cover Water Revenue bond and WIFA loan principal and interest payments)

- Bond covenants require that if the Net Revenue of any fiscal year does not equal or exceed 175% of the Senior Lien Annual Debt Service Requirement for that fiscal year, the City will deposit additional monies into a reserve account. For the fiscal year ended June 30, 2013, the debt coverage on Senior Lien Annual Debt Service Requirement was 201%.
- In addition, Mayor and Council policy require us to target an annual average debt coverage of combined Senior and Junior lien debt of at least 1.75. Debt service coverage for fiscal year 2013 was 1.75.

Financial Planning and Outlook

Each year, we develop a rolling six-year Financial Plan (current year plus five). This plan is built on Tucson Water's projected capital improvement and operating budgets, and our projected water sales revenues under existing rates. Our plan is aligned with the City of Tucson's budgetary process. This alignment enables Mayor and Council to be provided with the water revenue increases necessary to support operating and capital needs (over the five years of our financial plan period) as part of their review of those capital and operating budgets. As a result, our governing body has the opportunity to know the revenue/rate effects of the capital and operating plans being considered and can adjust the plans if the revenue/rate effects are not deemed acceptable.

Our Financial Plan for the period fiscal year 2013 -fiscal year 2018, which was adopted by Mayor and Council during fiscal year 2013, calls for annual water rate adjustments in all years of the Plan. Primary drivers behind the need for increased revenues include the projected continued reduction in water sales volumes (conservation efforts), the increasing cost of CAP water, and the financing of our capital program. We believe our financial planning process, combined with our ongoing improved efficiencies, positions us to meet our goals of continued reduced dependence on groundwater, increased reliability, and continued delivery of affordable, high quality water to our growing desert community.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Requests for Financial Information

Our annual report is intended to provide our customers, bondholders, and creditors with an overview of our operations and related financial activities. If you have any questions about our annual report or need additional financial information, contact Tucson Water Financial Services, P.O. Box 27210, Tucson, AZ 85726-7210, phone (520) 791-2666, or email TW_Web1@tucsonaz.gov.



FINANCIAL STATEMENTS

Page intentionally left blank.

FINANCIAL STATEMENTS

STATEMENT OF NET POSITION

June 30, 2013
(\$ in thousands)

Assets

Current assets:

Cash and cash equivalents

Undesignated \$33,120

Designated for customer deposits 1,738

Total cash and cash equivalents 34,858

Billed accounts receivable, net of allowance for doubtful accounts 13,174

Unbilled accounts receivable 12,677

Inventories, prepaids and other assets 3,918

Total current assets 64,627

Restricted assets:

Cash and cash equivalents 25,648

Cash and investments with fiscal agents 29,962

Other restricted assets 278

Total restricted assets 55,888

Long-term accounts receivable 452

Capital Assets:

Utility property, plant and equipment 1,469,642

Land and construction-in-progress 182,005

Less accumulated depreciation (461,243)

Water rights 52,127

Net capital assets 1,242,531

Total assets 1,363,498

Deferred Outflows

Loss on refunding of debt 14,392

Total deferred outflows 14,392

(Continued on next page)

FINANCIAL STATEMENTS

STATEMENT OF NET POSITION

June 30, 2013
(\$ in thousands)
(Continued)

Liabilities**Current liabilities:**

Accounts payable	\$3,051
Salaries, wages and payroll taxes payable	1,411
Current installments of revenue bonds payable	24,381
Current portion of compensated absences	1,744
Refundable/customer deposits	1,738

Total current liabilities	32,325
----------------------------------	---------------

Liabilities payable from restricted assets	33,909
--	--------

Long-term liabilities:

Revenue bonds payable	518,857
Compensated absences	1,890
Other post-employment benefits	972

Total long-term debt	521,719
-----------------------------	----------------

Total liabilities	587,953
--------------------------	----------------

Deferred Inflows

Unavailable revenue	62
---------------------	----

Total deferred inflows	62
-------------------------------	-----------

Net Position

Net investment in capital assets	718,490
----------------------------------	---------

Restricted for debt service	29,962
-----------------------------	--------

Unrestricted:

Conservation program	2,441
Other	38,982

Total unrestricted net position	41,423
--	---------------

Total net position	\$789,875
---------------------------	------------------

The notes to the financial statements are an integral part of this statement.

FINANCIAL STATEMENTS

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

Year ended June 30, 2013
(\$ in thousands)

Operating revenues:	
Potable water sales	\$121,886
Reclaimed water sales	9,296
Total water sales	131,182
Central Arizona Project charge	14,406
Water Conservaton Program fees	2,831
Connection fees	1,882
Billing services -	
Pima County Sewer, City of Tucson Environmental Services	3,401
Miscellaneous:	
TCE clean-up reimbursement	585
Service charges	3,860
Plan review and inspection fees	667
Reimbursed prior year expenses	183
Total miscellaneous	5,295
Total operating revenues	158,997
Operating expenses:	
Director's office:	
Personal services	2,149
Contractual services	2,970
Commodities	354
Total director's office	5,473
Business services:	
Personal services	579
Contractual services	1,738
Commodities	1,181
Total business services	3,498
Customer services:	
Personal services	6,749
Contractual services	448
Commodities	479
Total customer services	7,676
Water operations:	
Personal services	10,952
Contractual services	5,624
Commodities	3,417
Total water operations	19,993

(Continued on next page)

FINANCIAL STATEMENTS

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

Year ended June 30, 2013

(\$ in thousands)

(Continued)

Planning and engineering:	
Personal services	\$4,173
Contractual services	425
Commodities	338
	4,936
Total planning and engineering	4,936
Water quality management:	
Personal services	6,516
Contractual services	14,476
Commodities	1,527
	22,519
Total water quality	22,519
CAP water charges:	
Capital charges	2,163
Commodity charges	18,094
	20,257
Total CAP water charges	20,257
General expenses:	
Personal services	1,326
Contractual services	5,741
Commodities	90
	7,157
Total general expenses	7,157
Depreciation and goodwill amortization	29,543
	121,052
Total operating expenses	121,052
Net operating income	37,945
Nonoperating income:	
Investment earnings	546
Gain on sale of property/equipment	320
Federal grants and contributions	810
	1,676
Total nonoperating income	1,676
Nonoperating expenses:	
Interest expense	16,805
Debt issuance costs	65
Other nonoperating expenses	1,498
	18,368
Total nonoperating expenses	18,368
Net income before capital contributions	21,253
Capital contributions	8,162
Net transfers in/out	(1,600)
Change in net position	27,815
	762,060
Net position - July 1, restated (See Note 15)	762,060
	\$789,875
Net position - June 30	\$789,875

The notes to the financial statements are an integral part of this statement.

FINANCIAL STATEMENTS

STATEMENT OF CASH FLOWS

Year ended June 30, 2013

(\$ in thousands)

Cash flows from operating activities:

Cash received from customers	\$160,550
Cash payments to suppliers for goods and services	(60,544)
Cash payments to employees for services	(31,548)

Net cash provided by operating activities	68,458
--	---------------

Cash flows from noncapital financing activities:

Subsidy from federal grant	847
Internal activity payments to other funds	(1,600)

Net cash used by capital & noncapital financing activities	(753)
---	--------------

Cash flows from capital and related financing activities:

Bond proceeds	33,502
Acquisition and construction of capital assets	(69,780)
Principal paid on capital debt	(24,504)
Interest paid on capital debt	(18,025)
Capital Contributions–system equity fee	3,163
Fiscal agent fees paid on capital debt	(759)
Proceeds from sale of property and equipment	321

Net cash used in capital and related financing activities	(76,082)
--	-----------------

Cash flows from investing activities – interest received on investments	363
--	------------

Net decrease in cash and cash equivalents	(8,014)
--	----------------

Cash and cash equivalents at beginning of year	98,482
--	--------

Cash and cash equivalents at end of year	\$90,468
---	-----------------

(Continued on next page)

FINANCIAL STATEMENTS

STATEMENT OF CASH FLOWS

Year ended June 30, 2013

(\$ in thousands)

(Continued)

Reconciliation of operating income to net cash provided by operating activities:

Operating income	\$37,945
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation and amortization	29,543
Decrease (increase) in assets:	
Accounts receivable	1,168
Inventories	(1,232)
Prepays and other assets	101
Long-term accounts receivable	(125)
Increase (Decrease) in liabilities:	
Accounts payable	(287)
Accrued payroll liabilities	602
Compensated absences	107
Other post employment benefits	188
Due to other agencies	(62)
Customer refundable deposits	510
Net cash provided by operating activities	\$68,458
A reconciliation of cash and cash equivalents at June 30 follows:	
Unrestricted cash	34,858
Restricted cash (included in restricted assets)	55,610
Cash and cash equivalents at June 30	\$90,468
Noncash investing, capital and financing activities:	
Contributions of capital assets from developers	4,999
Refunding bonds	58,295
Defeased bonds	(52,845)
Total noncash activities	\$10,449

The notes to the financial statements are an integral part of this statement.

NOTES TO THE FINANCIAL STATEMENTS

(Amounts in \$1,000s)

1. DESCRIPTION OF THE BUSINESS

Tucson Water (the Utility), an enterprise fund of the City of Tucson, Arizona (the City), is operated and maintained as a self-supporting, municipally-owned utility of the City, providing customers with potable and reclaimed water. The Utility provides water service to approximately 713,000 people within a 300 square-mile service area that encompasses approximately 72% of the greater Tucson metropolitan area's total population. Customers are located both inside and outside of the City limits and are classified by the type of service they receive: residential, multifamily, mobile home park with sub-meters, and commercial, and industrial services.

A. Water Sources

During fiscal year 2013, the Utility obtained its municipal potable water – water quality meeting or exceeding all federal, state, and local drinking water standards – from two sources:

- four groundwater well fields (Central, Avra Valley, Santa Cruz, and Southside)
- facilities where the Utility recharges and recovers Colorado River water.

These four well fields and the recharge and recovery facilities provide the Utility with an aggregate production capacity of 214 million gallons of water per day.

The Utility's surface water source contract with the United States Department of the Interior and the Central Arizona Water Conservation District (CAWCD) provides access to 144,172 acre-feet annually of Colorado River water, delivered via the Central Arizona Project (CAP). The CAP consists of 335 miles of waterworks and associated facilities designed to deliver water from Lake Havasu on the Colorado River to Maricopa, Pinal, and Pima Counties in central/southern Arizona.

In fiscal year 2013, the Utility's recharge and recovery facilities pumped 71,712 acre-feet of blended recharged/recovered CAP water and groundwater into the Utility's distribution system. The Clearwater Renewable Resource Facility, constructed west of the City of Tucson, is composed of recharge basins, recovery well fields, and storage and transmission facilities. These facilities permit the recharge of approximately 129 million gallons per day (144,172 acre-feet/year) of Colorado River water, a renewable source. System-wide current recovery well capacity is 100.5 million gallons of water per day (112,574 acre-feet/year). Meeting nearly all of its customers' current demand for potable water with Colorado River water enables the Utility to reduce pumping groundwater from the central well field, over which the majority of the City lies, thereby easing concerns related to land subsidence. During 2013 the Utility produced up to 89.6 million gallons of water per day from the facilities.

NOTES TO THE FINANCIAL STATEMENTS

(Amounts in \$1,000s)

As part of a 1979 intergovernmental agreement (IGA) transferring the sewer system from the City to Pima County, the Utility was granted the right to use 90% of the effluent discharged from the metropolitan wastewater treatment facilities. Planning for use of this water resource was initiated in 1982. In 1984, the Utility began delivering reclaimed water, effluent treated to tertiary levels, to customers for turf irrigation. The Utility's reclaimed system currently includes:

- a reclaimed water treatment plant which processes effluent to a quality suitable for open-access turf irrigation
- a wetlands which biologically treats secondary effluent
- basins for the effluent recharge
- wells for recovery of the recharged water for delivery in the reclaimed distribution system.

In February 2000, the IGA was amended to resolve issues related to effluent and recharge permits. The amendment contained numerous agreements, including:

- 1) the City, Pima County and other effluent management entities (Marana/Oro Valley) agreed to establish a Conservation Effluent Pool for use on riparian projects,
- 2) the City and Pima County agreed to cooperatively plan and establish recharge basins for storage of effluent,
- 3) effluent from the new treatment facility at Ina Road would be divided among the City, Pima County and U.S. Department of the Interior,
- 4) the City would no longer control effluent from non-metropolitan treatment plants, and
- 5) the County could use its 10% of effluent for any public use.

In 2001, the City entered into agreements with the Metropolitan Domestic Water Improvement District and Oro Valley, transferring portions of its 90% allocation. In addition, in 2009 the City entered into similar effluent agreements with the Flowing Wells Irrigation District and Spanish Trail Water Company to transfer portions of its effluent allocation.

B. Assured Water Supply

The State of Arizona's Department of Water Resources' (ADWR) Assured Water Supply (AWS) Program is designed to encourage municipal water providers to shift their reliance from groundwater to renewable water sources. The AWS Program is ADWR's primary way of assuring that safe yield is reached. To demonstrate an assured water supply – AWS – means that sufficient water of adequate quality will be continuously available to meet the water needs of the proposed use for at least 100 years, and that

NOTES TO THE FINANCIAL STATEMENTS

(Amounts in \$1,000s)

the projected use is consistent with the management plan and achievement of the management goal for the Tucson AMA. The Utility has successfully demonstrated an AWS and has been granted a certificate of AWS Designation by ADWR.

It is important that the Utility have an AWS Designation because without it no new development beyond those lands currently platted can take place within the service area unless developers provide their own water supply. Receipt of the AWS Designation indicates a sufficient water supply is available to meet 100 years of projected demand for the existing population, committed demand (undeveloped, subdivided land within the service area) and provision for an increment of growth. The Utility qualified for the AWS Designation because of the construction of its recharge projects and its membership in the Central Arizona Groundwater Replenishment District (CAGRDR). The Utility's membership in the CAGRDR and the planned recharge projects enable the Utility to meet all criteria required for receipt of an AWS Designation.

The Utility entered into the membership agreement with the CAGRDR in December 1996 to ensure that it would meet the December 31, 1996 deadline for early application for an AWS Designation. By meeting the early filing deadline, the Utility was permitted to pump groundwater during 1998, 1999, and 2000 (about 300,000 acre feet) without being subject to the groundwater pumping limitations in the AWS rules. Pursuant to the terms of the agreement with CAGRDR, the Utility was committed to pay an annual replenishment tax for water recharged on its behalf. The first of six annual payments began in October 2002. The per acre-foot tax consisted of the current capital and commodity charges for CAP water, as established annually by CAWCD, plus an administrative fee, a CAGRDR capital facility fee and a CAGRDR recharge facility operational fee. The final payment was made in October of 2007.

During the preparation of the AWS Designation application, the Utility identified 42.9 million acre feet of available water supplies for the period 1997-2100. These calculations indicate that there is more than sufficient supply available for customers in its service area for approximately the next 100 years.

As the City continues to develop its water resource program, there may be changes in the way that the various supplies are used. In the future, the Utility's staff will work closely with ADWR to ensure the AWS Designation is not jeopardized.

NOTES TO THE FINANCIAL STATEMENTS

(Amounts in \$1,000s)

C. Utility Operations

The Utility is operated and maintained as a self-supporting, municipally-owned utility of the City. Although the Utility is a department of the City, it is operated in a manner similar to a private business enterprise where the costs of providing goods and services to its customers are financed primarily by user charges. A fund structure separate from other City accounts is maintained. The Utility's authority and responsibility is derived from the City's Charter and ordinances and resolutions of the City of Tucson's Mayor and Council. The Utility has within its organization virtually all of the elements of a self-contained entity. The Mayor and Council adopt the Utility's annual budget, establish water rates and fee structures in accordance with State laws governing municipal water systems, and provide overall policy direction.

To assist with the task of operating the Utility, the Mayor and Council have adopted water service policies. A number of these policies establish guidelines for the water financing and ratemaking process. These water service policies include, but are not necessarily limited to, the following concepts:

- All costs associated with the operation of the Utility (operating, maintenance, renewal and replacement, capital and debt service) will be funded from revenues derived from the Utility's water rates and other water-related income sources.
- Various combinations of revenue bonds and obligations, tax-secured bonds and water revenues are used to finance Utility capital improvements; regardless of what type of bond is used, repayment of the bonds shall be made only from Utility revenues.
- Some portion of the capital improvements are required to be funded from annual revenues to comply with existing bond covenants and Mayor and Council policy and to facilitate new debt issues by maintaining adequate debt coverage. Annual total debt coverage of at least 1.75 shall be maintained. The Utility was in compliance with debt coverage requirements for the fiscal year ended June 30, 2013.
- Mayor and Council's policy is for the utility to maintain cash reserves adequate for known future obligations and provide for potential shortfall in water sales revenues.
- Charges for services will be made on a cost of service basis. Water rate design elements will reflect the cost of service areas across customer classes and seasons, and will be designed so as to encourage water conservation and to control peak demand.
- Water rates and charges will be reviewed annually.

NOTES TO THE FINANCIAL STATEMENTS

(Amounts in \$1,000s)

Mayor and Council created the Citizens' Water Advisory Committee (CWAC) in 1977 as the official advisory body to the Council on water issues. The CWAC, composed of 15 members, annually reviews the Utility's 5-Year Financial Plan and its underlying capital improvement program, operating plans, and revenue forecasts, and makes recommendations to the Mayor and Council on rate adjustments.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. General

The Utility is an enterprise fund of the City. The enterprise fund accounts for the financing and operations of the Utility. All activities necessary to provide water services to Utility customers are accounted for within this enterprise fund. Any Utility annual revenues remaining after providing for operating and maintenance expense and capital project funding are retained by the Utility.

B. Basis of Accounting

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. Proprietary funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and liabilities associated with the operation of these funds are included on the Statement of Net Position. Net position is segregated into components. Proprietary fund-type operating statements present increases (e.g., revenues) and decreases (e.g., expenses) in total net position. Proprietary fund operating revenues, such as charges for services, result from exchange transactions associated with the principal activity of the fund. Exchange transactions are those in which each party receives and gives up essentially equal values. Nonoperating revenues, such as subsidies and investment earnings, result from non-exchange transactions or ancillary activities.

Basis of accounting refers to when revenues and expenses are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of the measurements made, regardless of the measurement focus applied. The accrual basis of accounting is utilized by proprietary fund types. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

NOTES TO THE FINANCIAL STATEMENTS

(Amounts in \$1,000s)

C. Use of Estimates in Preparing Financial Statements

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

D. Cash and Cash Equivalents

For the purpose of the statement of cash flows, the City considers all highly liquid investments (including the Utility's participation in the investment pool account and appropriate restricted assets) to be cash equivalents. The Utility's investments with an initial maturity date of 12 months or less when purchased are considered to be cash equivalents.

E. Investments/Deposits

The City maintains an investment pool that is available for use by all City funds, including the Utility. All assets of the investment pool are held by a single master custodian in trust. Pooled investments are reported at fair value. Income from pooled investments is allocated to individual funds based on each fund's monthly average daily cash balance in relation to total pooled investments.

Investments are reported at fair value. The fair value of the City's pooled investments is based on current market prices. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Investments that do not have established market prices are reported at estimated fair value. Estimated fair value for real estate investments are established by third party appraisers.

The Utility's interest earnings are recognized on the accrual basis. Changes in the fair value of investments are recognized as gains or losses on a monthly basis.

NOTES TO THE FINANCIAL STATEMENTS

(Amounts in \$1,000s)

F. Billed Accounts Receivable

Accounts receivable are uncollateralized customers obligations for charges for services. The carrying amount of accounts receivable is reduced by a valuation allowance that reflects management's best estimate of amounts that will not be collected. The allowance of doubtful accounts is based on management's assessment of the collectability of specific customer accounts and the aging of accounts receivable.

An allowance for doubtful accounts of \$627 was recorded as of June 30, 2013.

G. Unbilled Accounts Receivable

Unbilled accounts receivable are for charges for services provided but not billed to the customer.

H. Income and Other Taxes

Because the Utility is an enterprise fund of the City, a municipality exempt from federal and state income taxes, no provision for income taxes is included in the financial statements.

The Utility is subject to state and municipal (Tucson, South Tucson, Oro Valley and Marana) business privilege taxes. In addition, the City of Tucson levies a separate utility tax on the Utility's sales to customers residing within the City of Tucson limits and the State levies an environmental tax (to support Super-fund cleanup efforts) on all potable water sales.

The Utility makes an annual in-lieu-of property tax payment to the City's General Fund. The payment is reported as Net Transfers In/Out on the *Statement of Revenues, Expenses and Changes in Net Position* and was \$1,600 for fiscal year 2013.

I. Capital Assets

Property, plant, and equipment acquired prior to June 30, 1965 are stated at estimated historical cost. Additions subsequent to that date are stated at actual historical cost. Depreciation has been provided using the straight-line method over the following estimated useful lives.

Asset	Estimated useful life (years)
Buildings	40
Improvements other than buildings	10-40
Wells, reservoirs and improvements	40-100
Machinery and equipment	3 to 20

NOTES TO THE FINANCIAL STATEMENTS

(Amounts in \$1,000s)

The Utility capitalizes interest on capital projects if material, based on GASB standards. Interest costs capitalized during the fiscal year ended June 30, 2013 was \$3,915. Maintenance and repairs are expensed as incurred.

J. Goodwill

Goodwill is recorded upon the acquisition of Water companies and represents the excess of cost over fair value at the time of acquisition. Goodwill is amortized over 40 years using the straight-line method. Total goodwill of \$1,122 has been fully amortized.

K. Water Rights

The City does not place a limitation on the life on the Utility's water rights, an intangible capital asset, and does not expect to cease utilizing the water rights in the foreseeable future. Water rights are recorded at historical cost and are not amortized. The book value of the Utility's water rights was \$52,127 at June 30, 2013.

L. Restricted Assets/Liabilities

In accordance with applicable covenants of Utility bond issues, Mayor and Council Resolutions, or other agreements, appropriate assets and liabilities have been restricted.

M. Inventories/Prepays

Inventories and prepaid items are reported using the consumption method and consist primarily of expendable supplies. Inventories are maintained on a perpetual system and are primarily valued using the weighted-average cost method, which is not in excess of fair value. Expenses are recorded at the time inventories are consumed. Certain payments to vendors that reflect costs applicable to future periods are recorded as prepaid items.

N. Long-Term Obligations

Long-term debt and other long-term obligation are reported as liabilities on the Statement of Net Position. Bond premiums, discounts, and loss/gain on refunding – the difference between the reacquisition price and the net carrying amounts of old debt – are amortized over the life of the bonds using the straight-line method.

NOTES TO THE FINANCIAL STATEMENTS

(Amounts in \$1,000s)

The cost of employee vacation leave, sick leave, accumulated compensatory time, and any salary-related amounts are expensed as earned. Accrued compensated absences not expected to be utilized by employees within the next year are recorded as long-term liabilities. The long-term liability related to accrued, compensated absences was \$1,890 at June 30, 2013.

Post-employment health care and life insurance benefits (OPEB) are provided to retired employees in addition to pension benefits (see Note 12-C). The Utility's calculated long-term portion of these benefits is recorded as a long-term liability and was \$972 at June 30, 2013.

3. DEPOSITS/INVESTMENTS

The Utility had \$29,962 in cash and investments held with fiscal agents at June 30, 2013, included in restricted assets in the accompanying Statement of Net Position. Cash with fiscal agents was covered by collateral held in the fiscal agents' trust departments, not in the Utility's name. Each trust department pledges a pool of collateral against all trust deposits it holds. At year-end, the Utility had \$34,858 in unrestricted cash and cash equivalents and \$25,648 in restricted cash and cash equivalents.

The City maintains an investment pool that is available for use by all City funds. Each fund's portion of this pool is reported on the financial statements as "Pooled Cash and Investments." A single master custodian holds all assets of the investment pool. In addition, certain cash deposits and investments are also held separate by various City funds in separate accounts.

The majority of deposits and investments of the Tucson Supplemental Retirement System (TSRS), a defined benefit pension plan, are held in trust separately from those of other City funds by a master custodian. However, biweekly contributions to the fund for this plan are held in the investment pool to cover recurring expenditures.

NOTES TO THE FINANCIAL STATEMENTS

(Amounts in \$1,000s)

The following is a reconciliation of the City's deposit and investment balances as of June 30, 2013:

	Pooled Cash and Investments	Reconciling Adjustments	Total
Bank deposits	\$ 213,417	\$ (29,004)	\$ 184,413
Investments	692,837	115	692,952
Total	\$ 906,254	\$ (28,889)	\$ 877,365

	Government- wide Statement of Net Assets	Fiduciary Funds Statement of Net Assets	Total
Pooled cash and investments	\$ 153,541	\$ 5,224	\$ 158,765
Investments	31,591	661,361	692,952
Cash & investments restricted	25,648		25,648
Total	\$ 210,780	\$ 666,585	\$ 877,365

A. Deposits

Reconciling items in the previous table are made up of outstanding checks, deposits, in transit and other miscellaneous items. Bank balances are covered by federal depository insurance or collateral (if applicable) held by the City's agents in the City's name.

B. Investments

For the City investment pool, the City Charter and State Statutes authorize the City to invest in obligations typically rated by one or more nationally recognized statistical-rating organizations (NRSROs) i.e., Moody's/Standard & Poors. These obligations may consist of the U.S. Government Treasuries, Agencies and instrumentalities, money market funds consisting of primarily U.S. Governmental issues, repurchase agreements, negotiable and non-negotiable bank certificates of deposit (CDs), commercial paper rated P-2/A-2 or better, corporate bonds and notes rated A2/A or better, and the State of Arizona Local Government Investment Pool. Operating and capital projects funds may be invested for a maximum of five years based on projected construction schedules.

The Tucson Supplemental Retirement System (TSRS) is governed by a separate management board. The City Code provides that the TSRS Board of Trustees make investments in accordance with the "prudent person rule." Trust investments are also governed by an approved investment policy. The TSRS Board of Trustees authorizes

NOTES TO THE FINANCIAL STATEMENTS

(Amounts in \$1,000s)

domestic and foreign investments including U.S. Government obligations and Agency issues, corporate bonds, stocks, real estate, infrastructure and money market funds, as well as derivative investments. The investment policy also establishes the asset mix and target allocations for each asset class permitted.

Short-term investments for this fund may be made up of commercial paper, time deposits, guaranteed insurance contracts, money market funds or any other short-term investment fund (STIF) vehicle permitted.

The City's deposits and investments for all funds at fiscal year-end are listed below at fair value net of accruals. These deposits and investments are held by the City or its agents in the City's name and are either insured, registered or collateralized (if applicable). A portion of these investments are subject to credit risk (including custodial credit risk and concentrations of credit risk), interest rate risk and/or foreign currency risk which are all discussed in the sections that follow.

	<u>Fair Value</u>
U.S. issues not on securities loan:	
U.S. treasuries, agencies & other governmental bonds	\$ 213,210
Corporate bonds & other fixed income instruments	68,896
U.S. equity & commingled equity funds	300,360
Non-U.S. Issues not on securities loan:	
International bonds & other fixed income instruments	28,226
International equity & commingled equity funds	85,135
Sub-total	<u>695,827</u>
Investments held by broker-dealers under securities loans with cash collateral:	
U.S. treasuries, agencies & other governmental bonds	8,327
Corporate bonds & other fixed income instruments	5,125
U.S. equity	8,633
International bonds & other fixed income instruments	456
International equity	572
Sub-total	<u>23,113</u>
Securities lending short-term collateral investment pool	23,754
Money market funds/short-term investments	75,368
Real estate funds & commingled real estate funds	48,777
Infrastructure investment funds	39,415
Sub-total	<u>187,314</u>
Total deposits and investments	<u><u>\$ 906,254</u></u>

NOTES TO THE FINANCIAL STATEMENTS

(Amounts in \$1,000s)

C. Credit Risk

As defined by the Governmental Accounting Standards Board (GASB) in Statement 40, credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Associated with credit risk is concentration of credit risk and custodial credit risk. Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. Custodial credit risk for deposits is the risk that, in the event of failure of a depository financial institution, a government will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of investment or collateral securities that are in the possession of an outside party.

The City has the following investment policies governing the City investment pool account that addresses the various credit risks defined above. Investments shall be limited to the following instruments and percentages:

- 1) Obligations of the U.S. Government, its agencies and instrumentalities;
- 2) Repurchase agreements whose underlying collateral is commercial paper rated A-1/P-1 with maturities not to exceed 180 days or rated A-2/P-2 with maturities not to exceed 90 days,
- 3) Bonds, notes and debentures issued by U.S. corporations rated A2/A;
- 4) Money market funds, CD's, etc., either insured by an agency of the federal government or collateralized (if applicable), by obligations of the U.S. Government, its agencies and instrumentalities or General Obligation municipal bonds rated A/A2 or better at the minimum State of Arizona mandated required amount on deposit, calculated on market values. The collateral must be held by the Trust department of the financial institution or delivered to the City's agent;
- 5) Except for direct obligations of the U.S. Treasury or a U.S. agency, not more than 5% of the portfolio shall be invested in securities of any one issuer;
- 6) A minimum of 15% of the portfolio shall be in highly liquid securities, such as money market funds;
- 7) Not more than 25% of the portfolio shall be invested in medium-term corporate notes, commercial paper and negotiable certificates of deposit;
- 8) Not more than 20% of the portfolio shall be invested in Arizona municipal securities;
- 9) Not more than 25% of the portfolio shall be invested in 144A securities (applicable to large institutional investors only), subject to meeting all the investment policy requirements described above.

NOTES TO THE FINANCIAL STATEMENTS

(Amounts in \$1,000s)

The City's investment pool account had the following credit risk structure as of June 30, 2013:

Investment Type	Holdings	Average Credit Rating⁽¹⁾	Fair Value	Percent of Total
Cash & cash equivalents:				
Wells Fargo government mm fund	1	Aaa	\$ 36,709	18.57%
U.S. treasury notes	9	Aaa	99,946	50.55%
U.S. agency & municipal bonds	4	Aaa	18,875	9.55%
Negotiable certificates of deposit	5	Aa1	17,737	8.97%
Commercial paper	2	P-1	9,990	5.05%
U.S. corporate bonds	6	Aa3	14,457	7.31%
TOTAL	27		\$ 197,714	100%

Footnotes:

(1) Per Moody's Investors Service, Inc. (Moody's)

D. Interest Rate Risk

As defined by the Governmental Accounting Standards Board (GASB) in Statement 40, interest rate risk is the risk, whereby, changes in interest rates will adversely affect the fair value of investments. For fixed income securities, there is an inverse relationship between the change in interest rates and their fair value. For example, in a rising interest rate environment the value of fixed income securities will tend to fall by varying degrees depending on the length of their maturities. In general, the value of fixed income securities with a longer duration will tend to decrease more than shorter duration securities in a rising interest rate environment.

The City's investment pool account maintains the following investment policy with regard to interest rate risk:

- 1) Investment maturities shall be scheduled to enable the City to meet all operating requirements which may be reasonably anticipated;
- 2) A minimum of 15% of the portfolio shall be invested in highly liquid securities with a maturity of six months or less to meet the day-to-day operations of the City;

NOTES TO THE FINANCIAL STATEMENTS

(Amounts in \$1,000s)

- 3) Surplus and idle money not related to the day-to-day operation of the City may be invested in authorized investments with a final maturity not exceeding five years from the date of investment.

The City's investment pool account had the following maturity structure as of June 30, 2013:

<u>Investment Type/Maturity</u>	<u>Fair Value</u>	<u>Percent of Total</u>
<u>Cash & Cash Equivalents</u>		
Wells Fargo government mm fund	\$36,709	
	<u>36,709</u>	18.57%
<u>Less Than 1 Year</u>		
U.S. treasury notes	17,522	
Commercial paper	9,990	
Negotiable certificates of deposit	<u>2,202</u>	
	29,714	15.03%
<u>Between 1 to 2 Years</u>		
U.S. treasury notes	24,489	
U.S. agencies	3,594	
Negotiable certificates of deposit	15,535	
U.S. corporate bonds	<u>3,536</u>	
	47,154	23.85%
<u>Between 2 to 3 Years</u>		
U.S. treasury notes	57,935	
U.S. agencies	13,783	
U.S. corporate bonds	<u>10,921</u>	
	82,639	41.80%
<u>Between 3 to 5 Years</u>		
Municipal bonds	<u>1,498</u>	
	1,498	0.75%
TOTAL	<u>\$197,714</u>	<u>100%</u>

Effective Duration: 1.86 Years

NOTES TO THE FINANCIAL STATEMENTS

(Amounts in \$1,000s)

4. ACCOUNTS RECEIVABLE

A. Current

The Utility's current accounts receivable at June 30, 2013:

Billed accounts	\$13,801
Unbilled	12,677
Less: Allowance for doubtful accounts	(627)

Total current accounts receivable, net	\$25,851
---	-----------------

B. Long-Term

The Utility's long-term accounts receivable at June 30, 2013 of \$452; the balance is composed of long-term receivables from loan agreements with a local private golf enterprise and a local resort company. The loans are being repaid over ten-year periods.

NOTES TO THE FINANCIAL STATEMENTS
 (Amounts in \$1,000s)

5. RESTRICTED ASSETS AND LIABILITIES PAYABLE FROM RESTRICTED ASSETS

A. Restricted Assets

Restricted assets as of June 30, 2013 are detailed as follows:

Item	Restricted Purpose	\$ Amount
Restricted cash and cash equivalents		
Unspent revenue and obligation bond proceeds/proceeds receivable	Cash/investments held by the City/accrued interest loans receivable/other receivables restricted for authorized capital projects	\$ 22,123
Conservation fund	Cash/investments held by the City restricted for expenses in support of enhancing community conservation efforts	2,395
Area development fee proceeds	Cash/investments held by the City used for capital development in the City's water systems	1,130
	Total restricted cash and cash equivalents	25,648
Restricted cash and investments with fiscal agent		
	Cash/investments held by the City restricted for payment of matured revenue bond principal and interest	29,962
Other restricted assets		
	Accounts receivables within the above restricted accounts	278
	Total restricted assets	\$55,888

NOTES TO THE FINANCIAL STATEMENTS
 (Amounts in \$1,000s)

B. Liabilities Payable From Restricted Assets

Liabilities payable from restricted assets as of June 30, 2013 consist of the following:

Item	Restricted Purpose	\$ Amount
Debt service restricted assets	Matured bonds and interest payable	\$29,962
Unspent revenue bond/loan proceed assets	Accounts payable on authorized bond funded capital improvement projects/ due to other funds pending loan reimbursement	2,250
Construction project vendor deposited	Accounts payable, investments returnable to vendors (deposited in lieu of Utility retainage on construction payments)	1,524
Conservation fund	Accounts payable from Conservation Fund assets	173
Total liabilities payable from restricted assets		\$33,909

NOTES TO THE FINANCIAL STATEMENTS

(Amounts in \$1,000s)

6. CAPITAL ASSETS

The following is a summary of the changes in Capital Assets:

	Beginning Balance	Additions/ Transfers	Reductions/ Transfers	Ending Balance
Land	\$ 49,343			\$ 49,343
Construction-in-progress	106,216	\$ 71,045	\$ 44,599	132,662
Water rights	52,127			52,127
Capital assets being depreciated:				
Buildings	101,607	7,971		109,578
Equipment	41,749	1,107	225	42,631
Transmission & distribution systems	1,276,774	39,537		1,316,311
Goodwill	1,122			1,122
Total	1,628,938	119,660	44,824	1,703,774
Less accumulated depreciation:				
Buildings	42,117	2,894		45,011
Equipment	29,516	4,007	208	33,315
Transmission & distribution systems	359,143	22,652		381,795
Goodwill	1,122			1,122
Total accumulated depreciation	431,898	29,553	208	461,243
Capital assets, net	\$ 1,197,040	\$ 90,107	\$ 44,616	\$ 1,242,531

NOTES TO THE FINANCIAL STATEMENTS
(Amounts in \$1,000s)

7. CHANGES IN LONG-TERM DEBT

A summary of changes in long-term debt as of June 30, 2013 is as follows:

	Beginning Balance	Additions/ Refunded Issues	Reductions/ Refunded Issues	Ending Balance	Due Within One Year
Bonds and notes payable	\$ 511,581	\$ 83,873	\$ 77,349	\$ 518,105	\$ 24,381
Unamortized amounts:					
Bond sale premium	19,037	8,200	2,104	25,133	
Total water revenue bonds payable	530,618	92,073	79,453	543,238	24,381
Compensated absences	3,528	342	236	3,634	1,744
Other post employment benefits	784	188		972	
Total long term debt	\$ 534,930	\$ 92,603	\$ 79,689	\$ 547,844	\$ 26,125

NOTES TO THE FINANCIAL STATEMENTS

(Amounts in \$1,000s)

8. REVENUE BONDS AND NOTES PAYABLE

Water revenue and obligation bonds are secured by water sales revenues. The following is a summary of Water revenue bonds and obligations issued and outstanding as of June 30, 2013:

Water Utility Revenue Bonds and Notes Issued and Outstanding

Series	Interest Rates	Final Maturity Date	Original Amount	Balance Outstanding June 30, 2013
1993 Refunding	5.50	2014	\$ 35,360	\$ 1,705
1994 Series A (1996)	6.0 - 8.0	2018	33,000	1,250
2000 Series A (2001)	5.00	2014	37,800	500
2000 Series D (2004)	4.125 - 4.25	2014	18,765	500
2005 Refunding	5.00	2022	55,110	19,395
2005 Series A (2005)	3.50 - 4.45	2025	31,665	2,060
2006 Refunding	3.50 - 4.25	2024	85,460	82,055
2007 Refunding	5.00	2021	31,460	30,855
2005 Series B (2007)	4.375 - 5.00	2032	35,765	35,765
2005 Series C (2008)	4.00 - 5.00	2026	20,425	20,425
2009 Refunding	5.00	2019	2,815	2,815
Water System Revenue Obligations 2009	5.00	2029	35,635	35,635
Water System Revenue Obligations 2010	6.00	2030	38,510	38,510
Water System Revenue Obligations 2011	2.75 - 5.0	2032	30,965	30,965
2012 Refunding Series A	4.00 - 5.00	2018	36,120	36,120
2012 Refunding Series B	.571 - 1.767	2016	14,635	10,145
Water System Revenue Obligations 2012	2.00 - 5.00	2033	31,555	30,565
2013 Refunding Series A	2.00 - 5.00	2025	34,280	34,280
2013 Refunding Series B	.614 - 2.75	2022	18,825	18,825
Water System Revenue Obligation, Series 2013	1.50 - 5.00	2030	21,065	21,065
Jr Lien Water System Refunding Bond 2012	1.90	2021	15,245	12,950
2003 Water Infrastructure Finance Authority (WIF4)	3.44	2022	8,300	4,595

(Continued on next page)

NOTES TO THE FINANCIAL STATEMENTS

(Amounts in \$1,000s)

Water Utility Revenue Bonds and Notes Issued and Outstanding

Series	Interest Rates	Final Maturity Date	Original Amount	Balance Outstanding June 30, 2013
2000 Water Infrastructure Finance Authority (WIF5)	3.146 - 3.147	2023	3,000	1,796
2004 Water Infrastructure Finance Authority (WIF6)	3.255	2023	2,500	1,507
2005 Water Infrastructure Finance Authority (WIF7)	3.113	2024	2,997	1,943
2006 Water Infrastructure Finance Authority (WIF8)	3.424	2026	2,500	1,808
2007 Water Infrastructure Finance Authority (WIF9)	3.210	2026	2,000	1,438
2007 Water Infrastructure Finance Authority (WIF10)	3.208	2026	6,500	4,674
2007 Water Infrastructure Finance Authority (WIF11)	3.552	2027	17,800	13,694
2007 Water Infrastructure Finance Authority (WIF12)	3.600	2028	1,000	812
2007 Water Infrastructure Finance Authority (WIF13)	3.375	2028	2,500	2,125
2010 Water Infrastructure Finance Authority (WIF14)	2.928	2030	2,750	1,055 ⁽¹⁾
2011 Water Infrastructure Finance Authority (WIF15)	2.80	2031	16,000	13,182 ⁽¹⁾
2012 Water Infrastructure Finance Authority (WIF16)	2.80	2032	4,000	3,089 ⁽¹⁾
Total			\$736,307	\$518,105

(1) Water Infrastructure Finance Authority (WIFA) loans have not been fully drawn down as of June 30, 2013. The balance of the loans (\$3,735) is expected to be drawn down, and long-term debt recognized, during the next two fiscal years.

(Continued on next page)

NOTES TO THE FINANCIAL STATEMENTS

(Amounts in \$1,000s)

Maturities of the bonds, notes and related interest payable after June 30, 2013 are as follows:

Year ending June 30	Principal	Interest	Total
2014	\$23,606	\$22,324	\$45,930
2015	29,330	21,331	50,661
2016	30,803	20,317	51,120
2017	32,309	19,096	51,405
2018	33,204	17,886	51,090
2019-2023	184,557	68,036	252,593
2024-2028	123,033	31,556	154,589
2029-2033	61,263	6,544	67,807
Total	\$518,105	\$207,090	\$725,195

9. ADVANCED REFUNDING/DEFEASANCE OF DEBT

In prior years, the Utility has defeased various bond issues by creating irrevocable trusts. The proceeds from the advance refunding bonds have been deposited in these trusts and invested in U.S. Governmental Securities that are designed to meet the requirements of the refunded debt. The debt associated with the refunding issues, as well as the trust assets, has been removed from the Utility's basic financial statements. As of June 30, 2013, the amount of defeased debt outstanding, but removed, was \$90,750,000.

On May 21, 2013 and June 5, 2013, the City issued \$53,105 Water System Revenue Refunding Bonds Series 2013A and 2013B respectively, to refund Tax-Exempt Bonds Series 2001A Refunding; Taxable Water System Revenue Refunding Bonds Series 2005A; and Series 2005; and to pay costs related to the issuance of the bonds. The interest rate on Series A and Series B ranges from 2% to 5% and 1% to 2.75% respectively, with a final maturity due July 1, 2025 and July 1, 2022. Debt service payments are scheduled semi-annually at amounts ranging from \$175 to \$5,470. The economic gain resulting from refunds was \$3,564 (based upon NPV from delivery date). The difference in cash flow requirements to service the prior debt of \$71,087 and the cash flow to service the new debt of \$67,469 was 3,618.

NOTES TO THE FINANCIAL STATEMENTS

(Amounts in \$1,000s)

10. DEVELOPER CONTRIBUTIONS

Developers of land within the Utility's service area are required to install water distribution systems meeting the Utility's standards. Once completed and inspected by Utility staff, the developer donates the systems to the Utility. During the year ended June 30, 2013, developers donated water systems valued at \$4,999.

11. INSURANCE

The Utility is exposed to various risks of losses related to tort: theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The City has obtained commercial coverage for property insurance, public employee, fidelity bonds, crime insurance and miscellaneous insurance (surety bonds, special event insurance as needed and fine arts coverage). The City retains all of the risk not covered by commercial carriers and has effectively managed risk through various employee education and prevention programs.

The Utility pays a premium, calculated annually based on its claims history, to the City's Self-Insurance Fund. During Fiscal Year 2013, the Utility premium was \$1,328. All risk management activities of the City are accounted for in the Self-Insurance fund. Additional information on the City's Self Insurance Program is provided in **The City of Tucson's Comprehensive Annual Financial Report** (<http://finance.tucsonaz.gov/files/finance/CAFR13.pdf>).

12. PENSION PLAN/DEFERRED COMPENSATION PLANS/POST RETIREMENT BENEFITS

Utility employees are employees of the City of Tucson and required to participate in its pension plan. Participation in the separate deferred compensation and post-retirement benefit plans is optional. For a full disclosure of the City's pension and post retirement benefits, refer to the City's fiscal year 2013 Comprehensive Annual Financial Report.

NOTES TO THE FINANCIAL STATEMENTS

(Amounts in \$1,000s, except Note 3)

A. Pension Plan

Utility employees participate in the Tucson Supplemental Retirement System (TSRS), a single-employer defined benefit plan. It was established by City Charter to provide its members with a supplement to the retirement and disability benefits of the federal social security system. TSRS is governed by a seven-member Board of Trustees consisting of a chairman who is appointed by the Mayor, the City's Director's of Human Resources and Finance, two members elected by the system's membership a retired representative elected by TSRS retirees, and a member who is appointed by the City Manager. Benefit provisions and changes in benefits or funding are recommended by the Board of Trustees and must be approved by Mayor and Council. TSRS issues a publicly available financial report that includes financial statements and required supplementary information. The financial report may be obtained from the administrative office located at 255 W. Alameda Street, Tucson, AZ 85701, or online at http://cms3.tucsonaz.gov/files/finance/TSRS_CAFR_06302013.pdf.

Currently, employees hired prior to July 1, 2006 contribute 5% of their annual covered payroll and are made through payroll deductions. Employees hired after, June 30, 2006 contribute, via payroll deduction, 40% of the total required funding rate calculated annually by the pension system actuary. Future changes to employee contributions rates are limited to a maximum annual increase not to exceed 2.5% of base pay. For fiscal year 2013 the contribution rate of contribution for employees hired after June 30, 2006 was 13.976%.

A reserve is established for contributions and earnings allocations, less amounts transferred to reserves for retirement and disability and amounts reserved for terminated employees. The City contributes the remaining amounts necessary to finance employee participation in the System and to fund the costs of administering the System. The Utility's contribution rate for the year ended June 2013 for employees hired before July 1, 2006 and hired after June 30, 2006 was 29.94% and 20.96%, respectively. If an employee leaves covered employment before attaining five years of service credit, the accumulated contributions plus interest are refunded to the employee or his designated beneficiary.

The Utility's contribution to the TSRS was as follows (\$ in thousands):

Fiscal Year	Expenditures
2011	\$ 3,883
2012	4,841
2013	6,077

NOTES TO THE FINANCIAL STATEMENTS

(Amounts in \$1,000s, except Note 3)

B. Deferred Compensation

Utility employees may participate in a deferred compensation plan offered by the City and managed externally. The plan permits employees to defer a portion of their salaries until future years.

C. Post-Retirement Healthcare and Life Insurance Benefits

Post-employment health care and life insurance benefits are provided to retired employees in addition to pension benefits.

The City's policy on medical benefits for those retired before January 1, 2011 is to contribute 75% of the cost of retiree medical premiums prior to Medicare eligibility (age 65). Effective for retirements on or after January 1, 2011, the employer contribution is a fixed amount based on their plan choice. The benefits, benefit levels, employer and employee contributions are governed by the City and can be amended through management approval.

The City provides a life insurance benefit of \$7,500 to all retirees, regardless of age.

The costs for both the medical and life insurance retirement benefits are expended by the Utility as the appropriate premiums are paid. During the year ended June 30, 2013, the Utility's portion of retiree medical and life insurance premiums was \$1,116.

13. PLEDGED REVENUES

The City has pledged future Utility customer revenues, net of specified operating expenses, to repay \$518,105 million in utility system revenue bonds and water system revenue obligations issued since March 1993. Proceeds from these issues provided financing for the construction of various utility projects including water mains and water treatment plants. The bonds are payable solely from utility customer net revenues and are payable through June 2033. The total principal and interest remaining to be paid on the bonds was \$725,195. Fiscal year 2013 annual principal and interest payments on the bonds (\$46,379) utilized 59% of the fiscal year's net revenue (\$79,079).

NOTES TO THE FINANCIAL STATEMENTS

(Amounts in \$1,000s)

14. CONTINGENCIES AND COMMITMENTS**A. Operating Leases**

The Utility has entered into operating leases with terms in excess of one year which are not material when taken either individually or collectively and, therefore, are not disclosed in these notes. All the operating leases are cancelable. The Utility's total rent expense, resulting predominately from as needed rental of heavy equipment to support maintenance functions, was \$531 for the year ended June 30, 2013.

B. Litigation

The Utility is contingently liable with respect to lawsuits and other claims incidental to the ordinary course of its operations. At June 30, 2013, it was the opinion of management, based on the advice of the City Attorney, that any pending litigation would not have a material adverse effect on the Utility's financial condition or results of operations.

C. Construction Retainage and Other Commitments

The Utility enters into numerous capital improvement project contracts. Retainage on construction contracts for contract work completed as of June 30, 2013 are appropriately identified as accounts payable. Contract commitments for future capital improvement work totaled \$1,524 as of June 30, 2013.

D. Central Arizona Project (CAP) Contractual Obligation

The Central Arizona Water Conservation District (CAWCD) is the entity responsible for contracting with the Secretary of the Interior for CAP water and the resulting subcontracting with users within the State of Arizona. Under a contract between the City of Tucson, CAWCD and the Department of the Interior, the City currently has the right to receive 144,172 acre-feet of CAP water each year. In return, The City, via the Utility, agrees to pay a capital financing charge that is designed to recover a portion of the Federal Government's CAP construction costs. This charge, which must be paid regardless of whether the Utility orders any CAP water, is adjusted annually and is charged on a per-acre-foot of allocation basis. The CAP capital payment for the year was \$2,163.

NOTES TO THE FINANCIAL STATEMENTS

(Amounts in \$1,000s)

Also paid are commodity charges, which are designed to cover CAWCD operating and maintenance expenses, and are based on the quantity of CAP water taken by the Utility. In fiscal year 2013, Water purchased its full allotment of 144,172 acre-feet for the first time. The commodity charge for the year was \$18,094. Estimated CAP water expenses for the next five years are as follows:

CAP Payment Schedule (unaudited)

Fiscal Year	CAP Capital	CAP Commodity
2014	2,898	19,957
2015	3,028	21,845
2016	3,028	23,503
2017	3,100	25,233
2018	3,172	26,964

E. Water Quality Regulations

In 2011, the EPA issued a new health advisory for 1,4-dioxane of 0.35 parts per billion, significantly lower than the previous 3.0 parts per billion. To address the new level, the Utility has planned and designed a new water treatment facility with state-of-the-art technology to effectively remove 1,4-dioxane from groundwater pumped from the existing Tucson Airport Area Remediation Project (TARP) plant. Construction of this Advanced Oxidation Process Water Treatment Facility started in fiscal year 2012 and is expected to be completed by January 2014. The facility will work in conjunction with the adjacent TARP facility to produce up to 8 million gallons of purified water a day. It is estimated the facility will cost \$18,100 to construct and require \$1,000 in annual operating costs.

F. Federal Grants

Accounts received or receivable from federal agencies are subject to audit and adjustment by the grantor. Any disallowed claims, including amounts already collected, may constitute a liability to the Utility. The amounts, if any, of expenditures which may be disallowed by the grantor cannot be determined at this time, although the Utility expects such amounts, if any, to be immaterial.

NOTES TO THE FINANCIAL STATEMENTS

(Amounts in \$1,000s)

15. NEW GOVERNMENTAL ACCOUNTING STANDARDS BOARD (GASB) PRONOUNCEMENTS

The City implemented several GASB pronouncements that are disclosed below:

Statement No. 61, "The Financial Reporting Entity: Omnibus; an amendment of GASB Statements No. 14 and 34". This Statement modifies existing requirements for the assessment of potential component units in determining what should be included in the financial reporting entity, the display of component unit (blending vs. discrete) presentation, and certain disclosure requirements. This pronouncement did not impact the preparation of these financial statements.

Statement No. 62, "Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements". This Statement codifies into GASB accounting and financial reporting standards (the 'legacy' standards) from the private-sector. This pronouncement did not impact the preparation of these financial statements.

Statement No. 63, "Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position". This Statement establishes standards for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position and also requires related disclosures.

Statement No. 65, "Items Previously Reported as Assets and Liabilities". This Statement specifies the items that were previously reported as assets and liabilities that should now be reported as deferred outflows of resources, deferred inflows of resources, outflows of resources, or inflow of resources.

Statements No. 63 and 65 did impact the preparation of these financial statements. Items that were presented as liabilities are now presented on the face of the financial statements as deferred inflows. Since the Entity-wide statements present two fiscal year comparisons, the prior fiscal year (2012) is reclassified to show deferred inflows/outflows as appropriate. Statement 65 also required bond issue costs to be expensed when occurred instead of amortized over the life of the bond issue as required under previous guidance. This change required a restatement of the beginning net position as listed on the next page:

NOTES TO THE FINANCIAL STATEMENTS
(Amounts in \$1,000s)

Tucson Water

Unrestricted net position as previously reported	\$ 37,813
Change in accounting principal (GASB 65)	<u>(4,416)</u>
Unrestricted net position as restated	<u><u>\$ 33,397</u></u>

This information is an integral part of the accompanying financial statements.

Page intentionally left blank.



SUPPLEMENTARY INFORMATION

Page intentionally left blank.

SUPPLEMENTARY INFORMATION

SCHEDULE OF NET REVENUES AVAILABLE FOR DEBT

SERVICE⁽¹⁾

UNAUDITED

Per Ordinance No. 6347
Year ended June 30, 2013
(\$ in thousands)

Revenues:

Sale of water:

Potable water sales	\$124,717
Reclaimed water sales	9,296
Central Arizona Project charge	14,406
Connection fees	1,882
Environmental and sewer billing services	3,400
TCE cleanup reimbursement	585
Plan review and inspection fees	667
Other	4,044

Non-operating income:

Impact fees	3,163
Investment earnings – operating fund	129
Investment earnings – debt service	7
Federal contributions	810
Proceeds from sale of property/equipment	321
Proceeds from property/equipment rental	410
Total non-operating income	4,840

Total revenues 163,837

Operation and maintenance expenses:

Director's office	5,474
Business services	3,639
Customer services	7,676
Water operations	19,863
Planning and engineering	7,502
Quality management	9,693
Power - potable system	11,834
Power - reclaimed system	1,373
CAP water purchases:	
Commodity	18,094
Capital charges ⁽²⁾	2,163

Total CAP water purchases 20,257

General expenses	4,336
Capitalized operation and maintenance expense	(6,889)

Total operation and maintenance expense 84,758

Net revenue available after operations \$79,079

(Continued on next page)

SUPPLEMENTARY INFORMATION

SCHEDULE OF NET REVENUES AVAILABLE FOR DEBT SERVICE
UNAUDITED

Per Ordinance No. 6347
Year ended June 30, 2013
(\$ in thousands)
(Continued)

Bond Debt Service: ⁽²⁾⁽³⁾

Senior liens		
Interest		\$20,729
Principal		19,595
	Total debt service for water revenue bonds	40,324
Junior liens (Water Infrastructure Finance Authority)		
Interest		1,146
Principal		4,909
	Total debt service for Water Infrastructure Finance Authority	6,055
Combined senior and junior liens		
Interest		21,875
Principal		24,504
	Total debt service	46,379
	Net revenue available after operations and bond debt service for senior liens	\$38,755
	Net revenue available after operations and bond debt service for combined liens	\$32,700

Notes:

- (1) This is a special purpose financial statement intended to show compliance with City of Tucson Ordinance 6347. It is not prepared in accordance with Generally Accepted Accounting Principles (GAAP). Financials statements are presented on a GAAP basis.
- (2) Capitalized interest is not deducted from debt interest expense for interest expense for purpose of Ordinance 6347.
- (3) Section 5.02 (b) of Ordinance 6347 covenants that the City will issue additional senior lien bonds only if Net Revenue Available After Operations has been at least equal to 120% of the maximum future annual debt service requirement of \$45,509,771. The City's experience has shown that more favorable interest rates (and thus lower debt service costs) can be attained if such coverage is 150% to 200%. For the year ended June 30, 2013, maximum future annual debt service coverage of senior lien debt is 174%.

An amendment to Section 7.01 of Ordinance 6347 further requires that if the Net Revenue of any fiscal year does not equal or exceed 175% of the Senior Lien Annual Debt Service Requirement for that fiscal year, the City will deposit additional monies into a reserve account. For the fiscal year ended June 30, 2013, the debt coverage on Senior Lien Annual Debt Service Requirement was 196%.

The Water Utility's Junior Lien Debt has requirements that Net Revenues Available After Operations and Senior Lien debt service payments for any fiscal year must equal or exceed 175% of the Annual Debt Service Requirement for that fiscal year. If this requirement is not met, the City will deposit additional monies into a reserve account. For the fiscal year ended June 30, 2013, the debt coverage for the Annual Debt Service Requirement for the Junior Lien was 640%.

SUPPLEMENTARY INFORMATION

**RATE SCHEDULE FY 2013
UNAUDITED**

POTABLE WATER SERVICE RATES

A. MONTHLY MINIMUM CHARGE ⁽¹⁾

Meter Size (Inches)	Minimum Charge	Meter Size (Inches)	Minimum Charge
5/8	\$ 8.27	3	\$ 87.86
3/4	10.92	4	148.89
1	16.23	6	301.71
1 1/2	29.49	8	454.00
2	45.41	10	692.79
2 1/2	66.64	12	1,143.82

B. MONTHLY WATER USE CHARGES

Customer Class		Winter (per Ccf)⁽²⁾	Summer (per Ccf)⁽³⁾
Single family:	1-10 Ccf	\$1.26	\$1.26
	11-15 Ccf	2.45	2.45
	16-30 Ccf	6.45	6.45
	Over 30 ccf	10.45	10.45
Duplex-triplex:	1-15 Ccf	1.26	1.26
	16-20 Ccf	2.45	2.45
	21-35 Ccf	6.45	6.45
	Over 35 ccf	10.45	10.45
Multifamily:	Basic volume charge ⁽⁴⁾	2.29	2.29
Sub-metered mobile home parks:	Basic volume charge ⁽⁴⁾	1.75	1.75
Commercial:	Basic volume charge ⁽⁴⁾	2.25	2.25
	Summer surcharge - tier 1 ⁽⁵⁾		1.00
	Summer surcharge - tier 2 ⁽⁶⁾		0.27
Industrial:	Basic volume charge ⁽⁴⁾	2.05	2.05
	Summer surcharge - tier 1 ⁽⁵⁾		1.00
	Summer surcharge - tier 2 ⁽⁶⁾		0.27
Construction:	Basic volume charge ⁽⁴⁾	2.55	2.55

C. CENTRAL ARIZONA PROJECT CHARGE ⁽⁷⁾

Winter (per Ccf)⁽²⁾ Summer (per Ccf)⁽³⁾

\$0.36 \$0.36

D. CONSERVATION FEE ⁽⁸⁾

Winter (per Ccf)⁽²⁾ Summer (per Ccf)⁽³⁾

\$0.07 \$0.07

(Continued on next page)

SUPPLEMENTARY INFORMATION

RATE SCHEDULE FY 2013

UNAUDITED

(Continued)

The customer's monthly bill is calculated by adding together the monthly service charge, all monthly water use charges for the customer's class, the Central Arizona Project charge, and the conservation fee.

FIRE SPRINKLER SERVICE MONTHLY CHARGES

Monthly Service Charge:

Connection Size (Inches)	Minimum Charge	Connection Size (Inches)	Minimum Charge
2	\$ 8.20	8	\$ 58.45
3	13.43	10	88.29
4	20.76	12	143.78
6	39.61		

RECLAIMED WATER RATES

A. Monthly Service Charge:

Meter Size (Inches)	Rates	Meter Size (Inches)	Rates
5/8	\$ 6.66	4	\$ 104.69
1	12.21	6	211.22
1 1/2	21.46	8	317.38
2	32.55	10	483.84
2 1/2	47.35	12	798.27
3	62.15		

B. Monthly Service Charge:

Reclaimed water charge \$ / Ccf	\$1.83	(\$797 per acre foot)
---------------------------------	--------	-----------------------

The customer's monthly bill is calculated by adding together the monthly service charge and the monthly reclaimed use charge. The monthly reclaimed use charge is applied to all use.

Notes:

- (1) The monthly service charge is applicable to all customer classes.
- (2) Winter rates are applicable to water use from November through April.
- (3) Summer rates are applicable to water use from May through October.
- (4) Basic volume charges are applicable to all usage.
- (5) Summer surcharge - Tier 1 is applied to all use during a summer month which is in excess of the actual average monthly use during the previous six winter months. This surcharge is added to the basic volume charge.
- (6) Summer surcharge - Tier 2 is applied to all use during a summer month which exceeds 145 percent of the actual average monthly use during the previous six winter months. This surcharge is added to the basic volume and to the summer surcharge - Tier 1 charges.
- (7) The Central Arizona Project charge is applied to all potable water use.
- (8) The Conservation Fee is applied to all potable water use.

SUPPLEMENTARY INFORMATION

SCHEDULE OF FLOW OF FUNDS ⁽¹⁾

UNAUDITED

Year ended June 30, 2013

(\$ in thousands)

Excludes Conservation Program Fund

Revenues for operations and debt service:

Sale of potable water	\$121,886	
Sale of reclaimed water	9,296	
Total sale of water		131,182
Central Arizona Project charge		14,406
Connection fees		1,882
System equity fees		2,557
CAP resource fee		388
Taxes (state/local business privilege taxes and city utility taxes)		16,577

Investment income

Operating fund interest earnings	72	
Debt service fund interest earnings	1	
Bond fund interest earnings	64	

Total investment income available for operations and debt service		137
--	--	------------

Sewer billing services –

Pima County sewer, City of Tucson Environmental Services		3,400
--	--	-------

Miscellaneous revenue:

TCE clean-up reimbursement	585	
Area development fees	218	
Service charges	3,860	
Federal contributions/other agencies	810	
Plan review and inspection fees	667	
Prior year and reimbursed expenses	181	
Other	410	

Total miscellaneous revenue		6,731
------------------------------------	--	--------------

Other receipts:

Proceeds from sale of property and equipment		321
--	--	-----

Total revenues for operations and debt service		\$177,581
---	--	------------------

(Continued on next page)

SUPPLEMENTARY INFORMATION

SCHEDULE OF FLOW OF FUNDS ⁽¹⁾

UNAUDITED

Year ended June 30, 2013

(\$ in thousands)

Excludes Conservation Program Fund

Operations and maintenance expense:

Director's office			\$2,746
Business services			3,499
Customer services			7,676
Water operations (excluding power)			19,863
Planning and engineering (including waterline relocation)			4,930
Water quality management (excluding CAP water purchases/ power)			9,608
CAP water:	Capital charges	2,163	
	Commodity	18,094	
	Total CAP water		20,257
Power:	Potable system	11,834	
	Reclaimed system	1,373	
	Total power		13,207
General expense (including taxes)			14,545
Total operations and maintenance expense			96,331

Debt service on water revenue bonds/loans:	Water revenue and water obligation bonds - Senior Lien ⁽²⁾	Water infrastructure finance authority loans - Junior Lien ⁽²⁾	
Interest	20,729	1,146	21,875
Principal	19,595	4,909	24,504
	<u>40,324</u>	<u>6,055</u>	<u>46,379</u>
Fiscal agent fees			1,498
Total debt service on water revenue bonds/loans			47,877

Capital equipment from revenue and other sources (excludes capitalized interest) 17,496

Other uses:

Administrative service charges	9,028
Payment to general fund: in lieu tax	1,600
Increase in working capital	5,249
Total other uses	15,877
Total expenses, debt service, capital outlay and other uses	\$177,581

(Continued on next page)

SUPPLEMENTARY INFORMATION

SCHEDULE OF FLOW OF FUNDS ⁽¹⁾
UNAUDITED
 Year ended June 30, 2013
 (\$ in thousands)
 Excludes Conservation Program Fund

(1) This schedule presents a flow of funds under the methodology utilized by the Utility in determining needs for revenue adjustments. That methodology, approved by the American Water Works Association and reviewed by the Utility's independent rate consultant, looks at projected cash requirements for the year. This statement, based on actual results, enables the Utility to compare results with those projections.

(2) Debt service coverage calculation:

Revenues (excludes bond fund interest earnings)	\$ 177,517		
Operations and maintenance expense	96,331		
		<hr/>	
Revenues available for debt service (senior and junior lien)	81,186		
		<hr/>	
Less principal /interest water revenue bonds (senior lien)	40,324	Senior lien coverage	201%
Revenues available for debt service (junior lien)	40,862		
		<hr/>	
Less water Infrastructure Finance Authority loans	6,055	Junior lien coverage	675%
		<hr/>	
Balance available for capital investment and other uses	\$ 34,807	Combined coverage	175%

SUPPLEMENTARY INFORMATION

SCHEDULE OF FLOW OF FUNDS ⁽¹⁾

UNAUDITED

Year ended June 30, 2013

(\$ in thousands)

Conservation Program Fund

Revenues for operations and debt service:

Conservation program fees \$2,831

Investment income 3

Total revenues \$2,834

Operations and maintenance expense:

Director's office 2,728

Other uses:

Increase in conservation program reserves 106

Total expenses and other uses: \$2,834

(1) This schedule presents a flow of funds under the methodology utilized by the Utility in determining needs for revenue adjustments. That methodology, approved by the American Water Works Association and reviewed by the Utility's independent rate consultant, looks at projected cash requirements for the year. This statement, based on actual results, enables the Utility to compare results with those projections.

SUMMARY OF FLOW OF FUNDS

UNAUDITED

Year ended June 30, 2013

(\$ in millions)

CASH INFLOWS

What we received:

from sale of water ⁽¹⁾	\$ 148.4
from development/resource fees	2.9
from other revenues/sources ⁽²⁾	29.1

TOTAL	\$ 180.4
--------------	-----------------

CASH OUTFLOWS & USES

How much of our revenues we used for:

operations/maintenance ⁽³⁾	\$ 108.0
bond debt service (principal/interest) ⁽⁴⁾	44.0
capital improvements (revenue funded) ⁽⁴⁾	21.4
other purposes	1.6
increase in reserves	5.4

TOTAL OUTFLOWS/USES	\$ 180.4
----------------------------	-----------------

(1) includes CAP charge revenues

(2) includes taxes of \$16.6 million

(3) includes taxes of \$16.6 million and payment to City of Tucson for direct and indirect administrative support of \$9.0 million.

(4) Capitalized interest expense of \$3.9 million is reflected as a reduction to bond debt service and an increase in capital improvements.

Page intentionally left blank.

FY 2013 ANNUAL REPORT CONTRIBUTORS

Belinda Oden, Business Services Administrator

Shane Oman, Finance Manager

Theresa Bourne, Financial Accountant

Nancy Gradillas, Financial Accountant



(520) 791-4331
(520) 791-2639 TDD



tucsonaz.gov/water



youtube.com/tucsonwater



City of Tucson Water Department

P.O. Box 27210
Tucson, Arizona 85726-7210