

WESTERN HILLS WATER DISTRICT

FINANCIAL STATEMENTS

JUNE 30, 2019 and 2018

TABLE OF CONTENTS

	<u>Page No.</u>
Independent Auditors' Report	1 – 2
Management's Discussion and Analysis	3 – 7
Statements of Net Position	8
Statements of Revenues, Expenses and Changes in Net Position	9
Statements of Cash Flows	10
Notes to Financial Statements	11 – 25



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INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Western Hills Water District
Patterson, California

We have audited the accompanying financial statements of the business-type activities of Western Hills Water District (the District), as of and for the year ended June 30, 2019, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed in the table of contents.

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 opinions 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 opinions.


Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities Western Hills Water District, as of June 30, 2019, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

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 3-7 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic 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 basic financial statements, and other knowledge we obtained during our audit of the basic 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.


CROPPER ACCOUNTANCY CORPORATION
Walnut Creek, California
October 14, 2019

**Western Hills Water District
Management's Discussion and Analysis
For the year ended June 30, 2019**

This section of the District's annual financial report presents our analysis of the District's financial performance during the fiscal year that ended on June 30, 2019. Please read it in conjunction with the Basic Financial Statements, which follow this section.

FINANCIAL HIGHLIGHTS

- The District's total assets decreased by \$3,864,658, or 7.8%, to \$45.37 million.
- During the year the District's operating revenue increased by 36.4% to \$2.80 million, while operating expenses decreased by 1.7% to \$4.61 million.
- Due to the 2014 and 2015 short payments of the Mello Roos bonds, bond-related expenses increased from \$17 thousand to \$120 thousand, which includes \$90 thousand in collection efforts.
- Net position decreased by \$2.06 million to \$(18.43) million.

OVERVIEW OF THE FINANCIAL STATEMENTS

The discussion and analysis are intended to serve as an introduction to Western Hills Water District's basic financial statements. The District's MD&A is comprised of five components: Net Position, Revenues & Expenses, Capital Assets, Long-Term Debt and Future Challenges.

BASIC FINANCIAL STATEMENTS

The Statement of Net Position includes all of the District's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to District creditors (liabilities). It also provides the basis for computing rate of return, evaluating the capital structure of the District and assessing the liquidity and financial flexibility of the District.

The Financial Statements of the District report information about the District using accounting methods similar to those used by private section companies. These statements offer short and long-term financial information about its activities.

Capital assets, shown in Table 3, inform our bondholders that Western Hills Water District is spending their bond money in a manner that is consistent with increasing the assets that will ensure the District's overall future health.

Long-term debt has been secured by the special assessment on all property owned in this phase. These assessments will be charged through the year 2031. Even though the bonds are not the obligation of Western Hills Water District, the District has agreed to assume the accounting responsibility for these bonds.

**Western Hills Water District
Management's Discussion and Analysis
For the year ended June 30, 2019**

FINANCIAL ANALYSIS OF THE DISTRICT

One of the most important questions asked about the District's finances is, "Is the District, as a whole better off or worse off as a result of the year's activities?" You can think of the District's net position (the difference between assets and liabilities) as one way to measure financial health or financial position. Over time, increases or decreases in the District's net position are one indicator of whether its financial health is improving or deteriorating. However, until a new entity has stabilized, there may be mitigating factors on why net position tends to fluctuate up and down as shown in Table 1 below.

NET POSITION

To begin our analysis, a summary of the District's Statement of Net Position is presented in Table 1. As can be seen from the table below, net position decreased by \$2.06 million to \$(18.43) million in fiscal year 2019. This decrease is a result of the following:

1. Assets decreased by \$3.86 million, due to \$2.6 million in current and restricted assets that include \$2.3 million decrease in bond reserves and \$0.3 million in cash related to bond payments. Balance of capital assets change is due to \$1.3 million in depreciation.
2. Liabilities decreased by \$1.80 million, due to a net decrease in long-term debt.

**TABLE 1
Condensed Statements of Net Position
(in thousands)**

	2019	2018
Current Assets	\$ 4,383	\$ 4,731
Restricted Assets	2,146	4,444
Fixed Assets	38,844	40,063
Total Assets	45,373	49,238
Current Liabilities	24,601	23,475
Long-Term Debt	39,202	42,132
Total Liabilities	63,803	65,607
Net Position	\$ (18,430)	\$ (16,369)

REVENUE & EXPENSES

Western Hill's financial statements are extremely lopsided on the expense side. This is due to the fact that Western Hills is a very new district and has very few customers. This will be the norm until residential and commercial projects are started and completed for this district. Please see 2019's challenges at the end of this report.

**Western Hills Water District
Management's Discussion and Analysis
For the year ended June 30, 2019**

**TABLE 2
Statement of Revenues and Expenses
For the Years ended June 30, 2019 and 2018
(in thousands)**

	<u>2019</u>	<u>2018</u>	<u>Total % Change Fav/(Unfav)</u>
Total Operating Revenues	\$ 2,801	\$ 2,053	36.4%
Total Operating Expenses (less depreciation)	3,242	3,434	(5.6%)
Net Operating Loss Before Depreciation	\$ (441)	\$ (1,381)	68.1%

CAPITAL ASSETS

During 2019, the District had \$154 thousand of additional investment in the new water usage metering system which included new meters and electronic equipment.

**TABLE 3
Capital Assets
(in thousands)**

	<u>2019</u>	<u>2018</u>	<u>Dollar Change</u>	<u>Total % Change</u>
Land	\$ 782	\$ 782	\$ -	0.00%
Water Treatment Facilities/Equipt	12,235	11,775	460	3.91%
Pump Station & Well	4,104	3,389	715	21.10%
Aqueduct Turnout	746	746	-	0.00%
Wastewater Treatment Facility	28,104	28,104	-	0.00%
Back-up Generators	1,193	1,193	-	0.00%
Construction in Progress	10,726	11,755	(1,029)	(8.76)%
Vehicles	150	150	-	0.00%
Other	54	54	-	0.00%
Subtotal	58,094	57,948	146	0.25%
Less Accumulated Depreciation	19,250	17,886	1,364	7.63%
Net Book Value	\$ 38,844	\$ 40,062	\$ (1,218)	(3.04)%

LONG TERM DEBT

At year-end, the District had \$41.99 million in long-term debt (including the current portion). This is a net decrease of \$2.83 million from 2018, due to bond and note payments made during the year.

**Western Hills Water District
Management's Discussion and Analysis
For the year ended June 30, 2019**

The District has outstanding general obligation debt stemming from Mello-Roos bonds issued in 2014 and 2015. The District's current average cost of capital is shown on Table 4.

**TABLE 4
Outstanding Debt**

	<u>Debt Balance</u>	<u>Average Rate</u>
General Obligation Bonds	\$ 40,710	44.29%
Notes Payable	\$ 1,277	10.43%

2019 CHALLENGES AND A LOOK AT THE FUTURE:

Western Hills Water District's assets are notably in place as of June 30, 2019.

Western Hill's ongoing projects include the WTP SWPPP Implementation and Pump Station 2.

Upgrades: Capital upgrades for 2019 – 2020 will be limited to specific equipment needed.

Purchases: Capital expenditures for 2018 – 2019 were limited to \$193.3 thousand for new water usage metering and electronic collection system.

Financial: Operations are limited due to a small customer base. At this time, the water company receives its income from one golf course, forty acres of vineyards, residential housing, and a water banking program.

Setback: Water revenues have been held to a minor CIP increase per year. The water rate study that was performed in 2014 was defeated and there are no plans in 2020 to fund another study.

The district has the opportunity to sell excess water to five water districts but is limited to an allocation based on rain and snowfall. For 2018-2019 the district received \$753.2 thousand in excess water revenue as the water allocation was 65%. Water expense for same time period was approximately \$1.07 million.

Along with the water rate increase setback the district also incurred a rate increase setback for sewer expenses. The City of Patterson (COP) receives the districts sewer from a pipeline directly to their treatment facility. COP charges the district a rate that is 1.5 times the cities residential rate. In 2015 COP proposed a sewer service rate increase for the upcoming five years with increases each year. The first price increase took affect December 2, 2015. As the district is a customer of COP they are charged the rates approved/non- contested by city residents. Diablo Grande is considered rural.

The district proposed the new rates to the residents, of Diablo Grande, as a pass through and it was voted down. As of the year ended June 30, 2019 the district receives \$55.97/household per month and is charged \$70.67/household per month. The rate from COP will be increasing to \$74.91/household per month for the 2019-2020 year. The district is subsidizing the sewer at a cost of \$8.75 thousand/month to cover the COP monthly invoice. For 2019 – 2020 the amount will increase to \$11.3 thousand/month.

**Western Hills Water District
Management's Discussion and Analysis
For the year ended June 30, 2019**

The district is planning on meeting with COP for better rates but it is not looking favorable.

Additionally, the Developer has expressed reluctance to continue funding the District's losses.

Future: Capital purchase of a water truck is in the works as the current water truck is not CARB compliant and is often out of service. The monthly cost of renting a water truck is \$5.5 thousand.

Construction in progress (CIP): The district has \$10.730 thousand in CIP that relates to a plant upgrade that is 85% completed. The district has put the final phase on hold until further notice. Therefor CIP has carried a higher than average balance over the last five years.

Developer Relationship: Developer has put the property up for sale. When this property is sold the new ownership will need to agree and adhere to the Master Agreement the district has with the developer. As of now the current owners are reluctant to fully fund the short falls of the district.

Going Concern: There will be a lot of hurdles in 2019 – 2020 fiscal year. Rising water treatment, sewer and personnel cost without revenue to cover will put an even more substantial burden on the developer.

As of June 30, 2019, the district owes the current developer \$16.897 million. Until the district has enough housing and is self-sufficient there will not be any payments to the developer.

CONTACTING THE DISTRICT'S FINANCIAL MANAGER

This financial report is designed to provide our customers, investors, and creditors with a general overview of the District's finances and to demonstrate the District's accountability for the money it receives.

If you have questions about this report or need additional financial information please contact Western Hills Water District.

Western Hills Water District
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WESTERN HILLS WATER DISTRICT
 Statements of Net Position
 June 30, 2019 and 2018

	2019	2018
<u>ASSETS</u>		
Current Assets		
Cash (Note 2)	\$ 910,799	\$ 880,834
Restricted cash (Note 2)	2,365,252	2,720,191
Accounts receivable	491,273	654,848
Prepaid water charges	616,122	465,708
Meter inventory	-	9,393
Total current assets	4,383,446	4,730,974
Assets restricted for debt service, at current values		
Federated money market trust		
U.S. Treasury Obligations (Note 2)	2,146,068	4,444,378
Total restricted assets	2,146,068	4,444,378
Fixed Assets, net of accumulated depreciation of \$19,250,204 and \$17,885,721 for 2019 and 2018, respectively (Note 3)		
Construction in progress (Note 3)	28,117,596	28,306,198
Total assets	45,372,918	49,237,576
<u>LIABILITIES</u>		
Current Liabilities		
Accounts payable (Note 8)	4,107,048	4,176,242
Advances payable to World International LLC (Note 7)	16,896,995	15,759,995
Accrued interest payable	662,054	712,655
Customer deposits	141,400	134,300
Other current liabilities	8,790	8,189
Current portion of notes payable (Note 5)	409,821	383,521
Current portion of bonds payable (Note 4)	2,375,000	2,300,000
Total current liabilities	24,601,108	23,474,902
Notes payable, net of current portion (Note 5)	866,953	1,276,601
Bonds payable, net of current portion (Note 4)	38,335,000	40,855,000
Total liabilities	63,803,061	65,606,503
<u>NET POSITION</u>		
Invested in capital assets, net of related debt	(3,143,370)	(4,752,898)
Restricted for bond reserve funds (Note 4)	4,370,666	4,373,266
Unrestricted	(19,657,439)	(15,989,295)
Total net position (Note 6)	\$ (18,430,143)	\$ (16,368,927)

The accompanying notes are an integral part of these financial statements.

WESTERN HILLS WATER DISTRICT
 Statements of Revenues, Expenses and Changes in Net Position
 June 30, 2019 and 2018

	2019	2018
Operating Revenue		
Water revenue		
Residential	\$ 813,955	\$ 791,322
Commercial	75,307	7,149
Golf course	700,291	555,665
Water banking program	753,248	223,642
Sewer and stormdrain	429,457	380,921
Construction	-	(175)
Winery	4,411	7,777
Other	24,380	87,160
Total operating revenues	2,801,049	2,053,461
Operating Expenses		
Labor and related expenses	587,910	627,644
Purchased water	1,069,695	1,189,125
Waste water hauling and disposal	502,982	432,585
Water treatment	397,155	378,060
Utilities/fuel for pump	186,528	207,989
Maintenance	177,325	183,792
Contractual services	93,363	169,321
Insurance	55,667	39,499
Licenses and fees	4,300	4,250
General and administrative	156,112	182,018
Depreciation	1,364,483	1,249,661
Other	10,586	20,099
Total operating expenses	4,606,106	4,684,043
Operating loss	(1,805,057)	(2,630,582)
Non-Operating Revenue (Expenses)		
Property taxes	1,781,291	2,000,581
Investment income	65,747	64,574
Other income	82,608	82,108
Interest on bonded indebtedness	(1,965,734)	(2,141,423)
Other interest expense	(99,782)	(123,319)
Bond related expense	(120,289)	(17,054)
Total non-operating revenues (expenses)	(256,159)	(134,533)
Change in net position	(2,061,216)	(2,765,115)
Net position at beginning of year	(16,368,927)	(13,603,812)
Total net position at end of year	\$ (18,430,143)	\$ (16,368,927)

The accompanying notes are an integral part of these financial statements.

WESTERN HILLS WATER DISTRICT
Statements of Cash Flows
June 30, 2019 and 2018

	2019	2018
Cash flows from operating activities		
Receipts from customers and users	\$ 2,971,724	\$ 1,747,166
Payments to suppliers of goods and services	(2,872,720)	(2,711,973)
Payments to employees and related benefits	(587,910)	(627,644)
Net cash provided (used) in operating activities	(488,906)	(1,592,451)
Cash flows from capital and related financing activities		
Bond indebtedness retired	(2,445,000)	(2,080,000)
Payments on Caterpillar loan	(383,348)	(358,837)
Fixed asset additions, including construction in progress	(145,663)	(153,717)
Interest paid on bonded indebtedness	(2,016,335)	(2,138,288)
Other interest paid	(99,782)	(123,319)
Bond related expenses	(120,289)	(17,054)
Advances received from developer	1,137,000	1,050,000
Property taxes collected for debt	1,781,291	2,000,581
Recovery of bond costs	82,608	82,108
Net provided (used) in capital and financing activities	(2,209,518)	(1,738,526)
Cash flows from investing activities		
Proceeds from sales of investments	2,298,310	142,541
Investment income received	65,747	64,574
Sale of meter inventory	9,393	5,181
Net cash provided (used) in investing activities	2,373,450	212,296
Net increase (decrease) in cash	(324,974)	(3,118,681)
Cash at beginning of year	3,601,025	6,719,706
Cash at end of year	\$ 3,276,051	\$ 3,601,025
Presentation on Statement of Net Position		
Cash	\$ 910,799	\$ 880,834
Restricted Cash	2,365,252	2,720,191
Total Cash	\$ 3,276,051	\$ 3,601,025
Reconciliation of Operating Loss to Net Cash		
Provided by Operating Activities:		
Net operating loss	\$ (1,805,057)	\$ (2,630,582)
Adjustments to cash used in operating activities:		
Depreciation expense	1,364,483	1,249,661
(Increase) decrease in Accounts receivable	163,575	(343,766)
(Increase) decrease in Prepaid water charges	(150,414)	252,755
(Increase) decrease in Prepaid expenses	-	-
(Increase) decrease in Accounts receivable water banking	-	-
Increase (decrease) in Accounts payable	(69,194)	(159,772)
Increase (decrease) in Meter set deposits	7,100	37,471
Increase (decrease) in Taxes and insurance	601	1,782
Net cash provided (used) in operating activities	\$ (488,906)	\$ (1,592,451)

The accompanying notes are an integral part of these financial statements.

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2019 and 2018

1. Summary of Significant Accounting Policies

The accounting policies of the Western Hills Water District (the “District”) conform to accounting principles as applicable to governmental entities, which are classified as proprietary funds – business type, in the United States of America. The following is a summary of the more significant policies:

Reporting entity

For financial reporting purposes, in conformity with the Governmental Accounting Standards Board (“GASB”) Codification Section 2100, defining the governmental reporting entity, the District includes all funds that are controlled by or dependent on the Board of Directors of the District. Since no other entities are controlled by or rely upon the District, the reporting entity consists solely of the District.

Diablo Grande Community Facilities District No.1 – Bond Issues (see Note 4)

In August 2001, the Western Hills Water District - Diablo Grande Community Facilities District No. 1 issued \$21,000,000; in December 2002, issued \$6,650,000; in May 2004 issued \$20,000,000; and in January 2005 issued \$9,350,000 in bonds pursuant to the Mello-Roos Community Facilities Act of 1982. In August 2014, the 2001, 2002, and 2004 bonds, which had a remaining principal balance of \$38,710,000, were refunded by the 2014 Refunding Bond, with a principal balance of \$38,505,000. In July 2015 the 2005 bonds, with a balance of \$7,320,000, was refunded by the refunding of the 2015 Refunding Bond, \$7,260,000. The bonds are secured by and payable from a pledge of special taxes to be levied on approximately 5,070 acres of real property within the boundaries of the District. The Bond provisions indicate that:

“Neither the faith and credit nor the taxing power of the water district, the County of Stanislaus, the State of California or any political subdivision thereof is pledged to the payment of the bonds. The bonds do not constitute a debt of the water district within the meaning of any statutory or constitutional debt limitation.”

Although the provisions indicate the bonds are not an obligation of the Western Hills Water District, the District has assumed the responsibility of accounting for the proceeds and the future debt service. The bond proceeds funded the acquisition of water and wastewater facilities by the District. The costs of water facilities incurred in prior years were contributed to the District by Diablo Grande LP (Diablo Grande), the developer of the Diablo Grande project. The bond proceeds, net of certain costs of issuance and debt reserve requirements, have been used or set aside for current and future facility improvements.

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2019 and 2018

1. Summary of Significant Accounting Policies (continued)

Fund accounting classification

The financial statements of the District are presented as those of an enterprise fund under the broad category of funds called proprietary funds, which also includes internal service funds. Enterprise funds account for operations that are financed and operated in a manner similar to private business enterprises – where the intent is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered substantially through user charges. The acquisition of the physical plant facilities required to provide these goods and services, as indicated above, were initially financed by the developer, for the District, in anticipation of proceeds from the bond issue, which will further fund the additions to plant and equipment.

Basis of accounting

Enterprise funds are accounted for on the flow of economic measurement focus using the accrual basis of accounting. Revenues are recognized when they are earned, and expenses are recognized when they are incurred.

The GASB is the designated standard-setting body establishing governmental accounting and financial reporting principles.

The District follows alternative 1 of GASB 20 regarding the use of the pronouncements of the GASB and Financial Accounting Standards Board (“FASB”) in its accounting. That is, the District follows (1) all GASB pronouncements and (2) FASB pronouncements, Accounting Principles Board (“APB”) Opinions, and Accounting Research Bulletins (“ARB”) issued on or before November 30, 1989, except those that conflict with GASB pronouncements.

Cash and cash equivalents

For the purpose of the statement of cash flows, the District considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents, including short-term certificates of deposit. To date, only cash in bank is applicable.

Investments

State statutes authorize the District to invest in obligations of the U.S. Treasury, the Local Agency Investment Fund of the State of California (LAIF), commercial paper, corporate bonds and repurchase agreements.

Investments are carried at fair value. Fair value is based on quoted market price, if applicable, otherwise the fair value hierarchy is as follows.

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2019 and 2018

1. Summary of Significant Accounting Policies (continued)

Investments (continued)

Level 1 – Values are unadjusted quoted prices in active markets for identical assets or liabilities at the measurement date.

Level 2 –Inputs – other than quoted prices – included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3 – Certain inputs are unobservable inputs (supported by little or no market activity), such as the District's best estimate of what hypothetical market participants would use to determine a transaction price for the asset or liability at the reporting date.

Additional cash and investment disclosures are presented in Note 2. All of the District's investments are considered Level 1.

Meter inventory

Meter inventory is valued at average cost and recorded on the first in first out (FIFO) basis.

Fixed assets

Fixed assets are carried at historical cost or estimated historical cost if actual cost is not available. Contributed assets will be recorded at cost or estimated fair value on the date contributed.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized.

Depreciation expense is provided on a straight-line basis over 3 to 40 years depending on the category.

Vacation accrual

Accumulated unpaid employee vacation benefits are recognized as liabilities of the District. Full-time, exempt and non-exempt employees will normally accrue vacation time at the 5 days for first year of employment (after a 90 day introductory period), 10 days per year for the 2nd through 5th years of employment and 1 additional day per year for each year beyond 5 years, to a maximum of 15 days.

Net position

Net position is classified into three components: invested in capital assets, net of related debt; restricted for bond and reserve funds; and unrestricted. It is the policy of the District to spend funds in order from restricted to unrestricted.

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2019 and 2018

1. Summary of Significant Accounting Policies (continued)

Operating vs. non-operating revenues

Revenues related to providing water supply to customers and users are classified as operating revenue in the Statement of Revenues, Expenses and Changes in Net Position. All other revenues, including property taxes, are classified as non-operating revenue.

Property Taxes

Property tax revenue is recognized in the fiscal year for which the tax is levied. The County of Stanislaus levies, bills and collects property taxes for the District; all material amounts are collected by June 30.

Estimates in accounting

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and consequently, the reported amounts of revenues and expenses in the financial statements. The District's estimates relate primarily to estimates of useful lives of fixed assets and the determination of an allowance for uncollectible receivables (for which there are none for June 30, 2019 or 2018). Actual results could differ from these estimates.

Reclassifications

To conform to the presentation in the current year financial statements, certain items in the comparative prior year financial statements have been reclassified.

Implemented New GASB Pronouncements

GASB Statement No. 83, *Certain Asset Retirement Obligations*. - This Statement addresses accounting and financial reporting for certain asset retirement obligations (AROs). An ARO is a legally enforceable liability associated with the retirement of a tangible capital asset. A government that has legal obligations to perform future asset retirement activities related to its tangible capital assets should recognize a liability based on the guidance in this Statement.

The implementation of this pronouncement did not have a significant impact on the District's financial statements.

GASB Statement No. 88, *Certain Disclosures Related to Debt, Including Direct Borrowings and Direct Placements* - The primary objective of this Statement is to improve the information that is disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements. It also clarifies which liabilities governments should include when disclosing information related to debt.

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2019 and 2018

1. Summary of Significant Accounting Policies (continued)

Implemented New GASB Pronouncements (continued)

This Statement defines debt for purposes of disclosure in notes to financial statements as a liability that arises from a contractual obligation to pay cash (or other assets that may be used in lieu of cash) in one or more payments to settle an amount that is fixed at the date the contractual obligation is established.

The requirements of this Statement will improve financial reporting by providing users of financial statements with essential information that currently is not consistently provided. In addition, information about resources to liquidate debt and the risks associated with changes in terms associated with debt will be disclosed. As a result, users will have better information to understand the effects of debt on a government's future resource flows.

The implementation of this pronouncement did not have a significant impact on the District's financial statements.

Upcoming New GASB Pronouncements

GASB Statement No. 84, *Fiduciary Activities*. - The objective of this Statement is to improve guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported.

This Statement establishes criteria for identifying fiduciary activities of all state and local governments. The focus of the criteria generally is on (1) whether a government is controlling the assets of the fiduciary activity and (2) the beneficiaries with whom a fiduciary relationship exists. Separate criteria are included to identify fiduciary component units and postemployment benefit arrangements that are fiduciary activities. The requirements of this Statement are effective for the financial statements for periods beginning after December 15, 2018 (fiscal 2020). Earlier application is encouraged. The District doesn't believe this statement will have a significant impact on the District's financial statements.

GASB Statement No. 87, *Leases*. - The objective of this Statement is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments.

This Statement will increase the usefulness of governments' financial statements by requiring reporting of certain lease liabilities that currently are not reported. It will enhance comparability of financial statements among governments by requiring lessees and lessors to report leases under a single model. This Statement also will enhance the decision-usefulness of the information provided to financial statement users by requiring notes to financial statements related to the timing, significance, and purpose of a government's leasing arrangements. The requirements of this Statement are effective for reporting periods beginning after December 15, 2019 (fiscal 2021). Earlier application is encouraged.

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2019 and 2018

1. Summary of Significant Accounting Policies (continued)

Upcoming New GASB Pronouncements (continued)

GASB Statement No. 89, *Accounting for Interest Cost Incurred before the End of a Construction Period*. - The objectives of this Statement are (1) to enhance the relevance and comparability of information about capital assets and the cost of borrowing for a reporting period and (2) to simplify accounting for interest cost incurred before the end of a construction period.

The requirements of this Statement will improve financial reporting by providing users of financial statements with more relevant information about capital assets and the cost of borrowing for a reporting period. The resulting information also will enhance the comparability of information about capital assets and the cost of borrowing for a reporting period for both governmental activities and business-type activities. The requirements of this Statement are effective for reporting periods beginning after December 15, 2019 (fiscal 2021). Earlier application is encouraged. The requirements of this Statement should be applied prospectively.

GASB Statement No. 90, *Majority Equity Interests—an amendment of GASB Statements No. 14 and No. 61*. - The primary objectives of this Statement are to improve the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and to improve the relevance of financial statement information for certain component units. It defines a majority equity interest and specifies that a majority equity interest in a legally separate organization should be reported as an investment if a government's holding of the equity interest meets the definition of an investment.

The requirements of this Statement will improve financial reporting by providing users of financial statements with essential information related to presentation of majority equity interests in legally separate organizations that previously was reported inconsistently. In addition, requiring reporting of information about component units if the government acquires a 100 percent equity interest provides information about the cost of services to be provided by the component unit in relation to the consideration provided to acquire the component unit.

The requirements of this Statement are effective for reporting periods beginning after December 15, 2018 (fiscal 2020). Earlier application is encouraged. The requirements should be applied retroactively, except for the provisions related to (1) reporting a majority equity interest in a component unit and (2) reporting a component unit if the government acquires a 100 percent equity interest. Those provisions should be applied on a prospective basis.

GASB Statement No. 91, *Conduit Debt Obligations* - The primary objectives of this Statement are to provide a single method of reporting conduit debt obligations by issuers and eliminate diversity in practice associated with (1) commitments extended by issuers, (2) arrangements associated with conduit debt obligations, and (3) related note disclosures.

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2019 and 2018

1. Summary of Significant Accounting Policies (continued)

Upcoming New GASB Pronouncements (continued)

The requirements of this Statement will improve financial reporting by eliminating the existing option for issuers to report conduit debt obligations as their own liabilities, thereby ending significant diversity in practice. The clarified definition will resolve stakeholders' uncertainty as to whether a given financing is, in fact, a conduit debt obligation. Requiring issuers to recognize liabilities associated with additional commitments extended by issuers and to recognize assets and deferred inflows of resources related to certain arrangements associated with conduit debt obligations also will eliminate diversity, thereby improving comparability in reporting by issuers. Revised disclosure requirements will provide financial statement users with better information regarding the commitments issuers extend and the likelihood that they will fulfill those commitments. That information will inform users of the potential impact of such commitments on the financial resources of issuers and help users assess issuers' roles in conduit debt obligations.

The requirements of this Statement are effective for reporting periods beginning after December 15, 2020 (fiscal 2022). Earlier application is encouraged. The District doesn't believe this statement will have a significant impact on the District's financial statements.

2. Cash and Investments

The California Government Code requires California banks and savings and loan associations to secure a Public Agency's deposits by pledging government securities as collateral. The market value of pledged securities must equal at least 110% of deposits. California law also allows financial institutions to secure Public Agency deposits by pledging first trust deed mortgage notes having a value of 150% of the Public Agency's total deposits.

The cash balance (before outstanding checks) was held in one institution at June 30, 2019, and exceeded the FDIC insured amount of \$250,000 by \$3,477,947.

Cash and cash equivalents consist of the following:

	<u>June 30, 2019</u>	<u>June 30, 2018</u>
Cash	\$ 910,799	\$ 880,834
Restricted cash	<u>2,365,252</u>	<u>2,720,191</u>
Total cash	<u>\$ 3,276,051</u>	<u>\$ 3,601,025</u>

The June 30, 2019, investments in the US Treasury Money Market Trust of \$2,146,068 were reflected on the balance sheet as assets restricted for debt services.

Credit Risk

Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. Presented below is the minimum rating by the California Government Code and the actual rating as of the year-end for each investment type.

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2019 and 2018

2. Cash and Investments (continued)

Investment Type	Fair Value	Minimum Not Required		Rating as of Year End		
		Legal Rating	To Be Rated	AAA	A	Unrated
US Treasury Money Market	\$2,146,068	N/A	\$ 2,146,068	\$ -	\$ -	\$ -

Restricted Cash

Cash in the amount \$2,365,252 has been restricted by loan agreements for the payment of loan debt service. At June 30, 2019, the District was required to reserve \$4,370,666 of funds for debt service.

The restricted cash balance is related to the reserve fund requirements. During the current year the District used nearly half of the reserve fund requirement to pay the debt service due in September 2018. See additional information in Note 4.

3. Fixed Assets

All purchased assets are valued at cost. In accordance with generally accepted accounting principles for proprietary entities, depreciation has been provided on the straight-line method over estimated useful lives of three to forty years.

The following reflects the changes in fixed assets for the year ended June 30, 2019:

	Balance June 30, 2018	Reclassifications & Additions	Balance June 30, 2019	Depreciable Life in Years
Land	\$ 782,393	\$ -	\$ 782,393	n/a
Water treatment facilities	11,687,308	-	11,687,308	40
Water treatment equipment	87,387	460,612	547,999	3 to 5
Pump station & well	3,388,913	715,269	4,104,182	30
Aqueduct turnout	745,802	-	745,802	40
Wastewater treatment facility	28,103,909	-	28,103,909	40
Back-up generators	1,192,610	-	1,192,610	15
Frog pond	10,803	-	10,803	30
Vehicles	149,667	-	149,667	5
Other	43,127	-	43,127	3 to 40
	46,191,919	1,175,881	47,367,800	
Accumulated depreciation	17,885,721	1,364,483	19,250,204	
Net book value	\$28,306,198	\$ (188,602)	\$28,117,596	
Construction in progress	\$11,756,026	\$ (1,030,218)	\$10,725,808	n/a

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2019 and 2018

4. “Mello-Roos” Assessment District – Western Hills Water District - Diablo Grande Community Facilities District No. 1

Refunding Revenue Bonds - 2015

In August 2015, the District issued \$7,260,000 of Refunding Revenue Bonds with interest rates ranging from 2.250% to 4.750%. The Bonds are secured by a pledge of special tax revenue. Principle payments are due annually on September 1, and interest is payable semi-annually on September 1 and March 1.

The District issued the 2015 Refunding Revenue Bonds to advance refund the 2005 Revenue Installment Certificates, which had interest rates of 4.650% to 5.800%. The net proceeds were deposited in an escrow fund to service and redeem the debt. As a result, the advance refunding met the requirements of an in-substance debt defeasance, and the outstanding balance of the 2005 debt was removed from the District’s accounts. The 2005 debt issues no longer have any outstanding balance.

Refunding Revenue Bonds – 2015 (continued)

Total costs of the 2015 Refunding Revenue Bonds recognized as non-operating expense for the fiscal year ended June 30, 2016 was \$421,409, including an original issue discount of \$105,540.

The District completed the 2015 refunding of the 2005 special tax bonds to reduce its total debt service (net of the costs of the refunding) over 16 years by \$550,121 and to obtain an economic gain of \$511,370. The economic gain is the difference between the present values of the old and new debt service payments, based on the effective interest rate on the 2015 Refunding Revenue Bonds of 4.46%.

Refunding Revenue Bonds – 2014

In August 2014, the District issued \$38,505,000 of Refunding Revenue Bonds with interest rates ranging from 2.0% to 5.3%. The Bonds are secured by a pledge of special tax revenue. Principal payments are due annually on September 1, and interest is payable semi-annually on September 1 and March 1.

The District issued the 2014 Refunding Revenue Bonds to advance refund the 2001, 2002, and 2004 Revenue Installment Certificates, which had interest rates of 4.65 to 6.875%. The net proceeds were deposited in an escrow fund to service and redeem the debt. As a result, the advance refunding met the requirements of an in-substance debt defeasance, and the outstanding balance of the 2001, 2002, and 2004 debt was removed from the District’s accounts. The 2001, 2002, and 2004 debt issues no longer have any outstanding balance.

Total costs of the 2014 Refunding Revenue Bonds recognized as non-operating expense for the fiscal year ended June 30, 2015 was \$1,310,601, including an original issue discount of \$592,787.

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2019 and 2018

4. "Mello-Roos" Assessment District - Western Hills Water District - Diablo Grande Community Facilities District No. 1 (continued)

The District completed the 2014 refunding of the 2001, 2002 and 2004 special tax bonds to reduce its total debt service (net of the costs of the refunding) over the next 17 years by \$3,050,334 and to obtain an economic gain of \$2,771,279. The economic gain is the difference between the present values of the old and new debt service payments, based on the effective interest rate on the 2014 Refunding Revenue Bonds of 5.2%.

The changes in the District's long-term obligations were as follows:

	Year Ended <u>June 30, 2019</u>	Year Ended <u>June 30, 2018</u>
Balance at beginning of year	\$ 43,155,000	\$ 45,235,000
New issuance- bond refunding	-	-
Bond retirements	(2,445,000)	(2,080,000)
Principal payments	-	-
Balance at end of year	<u>\$ 40,710,000</u>	<u>\$ 43,155,000</u>
Due in one year	<u>\$ 2,375,000</u>	<u>\$ 2,300,000</u>

Debt Schedules

The following are debt service schedules to maturity:

	<u>2014 Bond</u>		
Fiscal Year Ending June 30,	Interest	Principal	Total
2020	\$ 1,669,010	\$ 1,975,000	\$ 3,644,010
2021	1,588,510	2,050,000	3,638,510
2022	1,505,010	2,125,000	3,630,010
2023	1,406,708	2,210,000	3,616,708
2024	1,292,199	2,325,000	3,617,199
Thereafter	<u>5,304,531</u>	<u>23,345,000</u>	<u>28,649,531</u>
	<u>\$ 12,765,968</u>	<u>\$ 34,030,000</u>	<u>\$ 46,940,968</u>

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WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2019 and 2018

4. “Mello-Roos” Assessment District – Western Hills Water District - Diablo Grande Community Facilities District No. 1 (continued)

Debt Schedules (continued)

The following are debt service schedules to maturity:

Fiscal Year Ending June 30,	<u>2015 Bond</u>		
	Interest	Principal	Total
2020	\$ 270,400	\$ 400,000	\$ 670,400
2021	255,538	420,000	675,538
2022	240,041	435,000	675,041
2023	223,341	455,000	678,341
2024	205,419	470,000	675,419
Thereafter	<u>848,527</u>	<u>4,500,000</u>	<u>5,348,527</u>
	<u>\$ 2,043,266</u>	<u>\$ 6,680,000</u>	<u>\$ 8,723,266</u>

Fiscal Year Ending June 30,	<u>All Bonds</u>		
	Interest	Principal	Total
2020	\$ 1,939,410	\$ 2,375,000	\$ 4,314,410
2021	1,844,048	2,470,000	4,314,048
2022	1,745,051	2,560,000	4,305,051
2023	1,630,049	2,665,000	4,295,049
2024	1,497,618	2,795,000	4,292,618
Thereafter	<u>6,153,058</u>	<u>27,845,000</u>	<u>33,998,058</u>
	<u>\$ 14,809,234</u>	<u>\$ 40,710,000</u>	<u>\$ 55,519,234</u>

Reserve requirement restrictions

The provisions of the “official statements” of the bond issues require the following restrictions:

Reserve fund

The District is required to maintain an amount equal to the lesser of as of June 30, 2019:

- (a) 10% of the original principal: \$4,576,500
- (b) 100% of the maximum annual debt service on the bonds based on years ended September 1:
\$4,370,666
- (c) 125% of the average annual debt service: \$5,388,875

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2019 and 2018

4. “Mello-Roos” Assessment District - Western Hills Water District - Diablo Grande Community Facilities District No. 1 (continued)

Reserve fund (continued)

The purpose of this \$4,370,666 reserve is to be used for debt service, if needed. Amounts in excess of the requirement, due to interest thereon, can be transferred to the Bond Fund to be used for current debt service. When the Reserve Fund exceeds the requirement to redeem the remaining outstanding bonds such excess shall be transferred to the District to be used for any lawful purpose.

The remaining proceeds of the bond issue after allowing for costs of issuance were set aside to reimburse improvement costs.

During the current year the District had to use nearly half of the required reserve fund to pay the debt service due in September 2018. The September 2019 debt service payments brought the reserve fund balance down to \$0. The September 2019 debt service payments paid in full the Series 2015 Bond debt service but was unable to pay in full the Series 2014 Bond debt service.

The developer, World International, is responsible for approximately 98% of the fiscal year 2018-2019 special tax delinquencies. Additionally, World International is also delinquent in payment of the special tax levy for fiscal year 2017-2018. See Note 7 for details on the relationship between the District and World International.

At June 30, 2019, the reserve requirements were as follows:

Reserve Fund- 2014 Bond	\$ 3,683,510
Reserve Fund- 2015 Bond	687,156
Total reserve requirement	<u>\$ 4,370,666</u>
Funds set aside for debt service at June 30, 2019	<u>\$ 2,146,068</u>

The indebtedness will be retired over a seventeen-year period from assessed parcel taxes on the properties being developed, through the District.

5. Notes Payable

In June of 2007, the District entered into a note agreement with Caterpillar Financial Services Corporation with the proceeds used for the government lease purchase of five Caterpillar generator sets packages with a SCADA system and four automatic transfer switches, all of which securitizes the agreement. The total amount borrowed under this agreement of \$4,173,847 was originally payable in 102 equal monthly installments at 5.97% interest. The original agreement was amended on May 28, 2009, and again on June 15, 2012 to revise the payment schedule. The amended interest rate is 6.41%.

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2019 and 2018

5. Notes Payable (continued)

The following is the debt service schedule to maturity for the Caterpillar note payable, including the effect of both amendments:

Fiscal Year Ending June 30,	Interest	Principal	Total
2020	66,560	384,572	451,132
2021	40,638	410,494	451,132
2022	13,151	400,388	413,539
	<u>\$ 120,349</u>	<u>\$ 1,195,454</u>	<u>\$ 1,315,803</u>

In October 2016, the District entered into three note agreements for the purchase of three Dodge Ram 1500 trucks. The total amount borrowed under these agreements of \$138,997 is payable in sixty to seventy-two equal monthly installments at annual interest rates ranging from 8.72% to 10.42%.

The following is the debt service schedule to maturity for the three Dodge Ram notes payable:

Fiscal Year Ending June 30,	Interest	Principal	Total
2020	6,746	25,249	31,995
2021	4,218	27,775	31,993
2022	1,669	22,469	24,138
2023	90	5,827	5,917
	<u>\$ 12,723</u>	<u>\$ 81,320</u>	<u>\$ 93,843</u>

All Notes

Fiscal Year Ending June 30,	Interest	Principal	Total
2020	73,306	409,821	483,127
2021	44,856	438,269	483,125
2022	14,820	422,857	437,677
2023	90	5,827	5,917
	<u>\$ 133,072</u>	<u>\$ 1,276,774</u>	<u>\$ 1,409,846</u>

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2019 and 2018

6. Going Concern

The District has incurred operating losses of \$1,805,057 in 2019 and \$2,630,582 in 2018. At June 30, 2019 and 2018, the District's deficit net position was \$(18,430,143) and \$(16,368,927), respectively, which indicates that the District is theoretically insolvent. The net investments in capital assets, which is the value of those assets less the outstanding amount owed on the debt used to acquire them was \$(3,143,370) and \$(4,752,898) at June 30, 2019 and 2018, respectively.

The District's negative net position as described above raises substantial doubt about the District's ability to continue as a going concern within one year after the issuance date of the financial statements. District management is working with the owner of the development to promote the completion of the community, which may result in more home sales. More home sales would also result in more sewer service charges and more property tax revenues, which are necessary to repay the outstanding obligations of the District and cover its operating costs.

The District's assets are substantially in place as of June 30, 2019 and 2018. However, the operations including water revenue will not be fully realized until the development is completed. At June 30, 2019 and 2018, the primary customers were the golf course, clubhouse/restaurant, vineyard and the first phase of residential development homeowners. The development plan includes a hotel, single family homes, condos and public facilities. Until it comes to fruition, the water revenue will not cover expenses. It is anticipated, but not guaranteed, that the deficit will be funded by the developer (see Note 7 for more detail).

The accompanying financial statements have been prepared assuming that the District will continue as a going concern; however, the above conditions raise substantial doubt about the District's ability to do so. The financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classifications of liabilities that may result should the District be able to continue as a going concern.

7. Related Parties

World International LLC – the Developer acquired the property contained in the District through the bankruptcy proceedings of Diablo Grande LP. As of June 30, 2019 and 2018, advances payable to World International LLC were \$16,896,995 and \$15,759,995, respectively.

The Developer is delinquent in payments of the special tax levy for fiscal years 2017-2018 and 2018-2019. See Note 4 for additional information.

WESTERN HILLS WATER DISTRICT
Notes to Financial Statements
June 30, 2019 and 2018

8. Payables Concentration

Of the total accounts payable balance of \$4,107,048 and \$4,176,242 at June 30, 2019 and 2018, respectively, \$4,000,626 was a delinquent account payable to Veolia Water in both years. As of the date of this report, Veolia Water has not pursued any litigation to collect the delinquent balance due from the District.

9. Potential litigation

The District has been invoiced \$84,334 in overhead charges. The District considers these charges to be baseless and has been fighting the charge. There has been no overt threat of litigation made against the District. The District considers it is reasonably possible that the District will prevail in the event litigation is commenced against the District.

The \$84,334 is not included in accounts payable on these financial statements.

10. Subsequent Events

Management has evaluated subsequent events through the date of the audit opinion letter, which is the date the financial statements were available to be issued.

On September 5, 2019 the District received a written communication letter from their bond fiscal agent to inform the District that the Fiscal agent was unable to pay the regular principal and the regular interest payment of \$2,822,935 due for the scheduled payment of September 3, 2019, due to insufficient funds held in the Bond Fund and the Reserve Fund.

On September 13, 2019, the District's dissemination agent wrote to the Municipal Securities Rulemaking Board (MSRB) to inform them of the delinquent debt service payments due to insufficient funds in the Bond Fund and the Reserve Fund.