

CITY OF COTTONWOOD, ARIZONA  
WATER AND WASTEWATER RATE STUDY AND  
LONG-TERM FINANCIAL FORECAST  
2013 UPDATE

July 2, 2013

Prepared by:  
City of Cottonwood Administrative Services  
816 North Main Street  
Cottonwood, Arizona 86326  
(928) 340-2710

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## ACKNOWLEDGEMENTS

The compilation of this rate study required hours of time and effort by a Rate Review Committee consisting of City employees, citizens from the community, and county representatives. These committee members included:



### City Employees

- Diane Joens, Mayor,
- Terrance Pratt, City Council member,
- Douglas Bartosh, City Manager,
- Dan Lueder, Developmental Services General Manager,
- Kirsten Lennon, Accounting & Budget Manager,
- Carol Brown, Budget Analyst,
- Helen Bartels, Utilities Accountant,
- Tom Whitmer, Water Resources Director
- Tawni Fanning, Utility Billing Supervisor,
- Sharon Caldwell, Utility Administrative Coordinator,
- Roger Biggs, Utilities Administrative Manager,
- Morgan Scott, Public Work Operations Manager
- Scott Mangarpan, Projects Manager
- Deborah Breitreutz, Wastewater Utility Operations Manager
- Administrative Services Staff, and
- Utilities Staff.

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### City Representatives

- Ed Kiyler, Citizen Advisor,
- Jake Gonzales, Citizen Advisor.

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### County Representative

- Chris Moran, Yavapai County Representative.

The City also included the City's financing consultant, Grant Hamill, Managing Director, Stifel, Nicolaus & Company. The Administrative Services staff is very appreciative of all of the assistance from everyone involved in this report. Without their input this report would not have been possible.

Respectfully submitted,

Jesus R. Rodriguez, C.G.F.M.  
Administrative Services General Manager  
City of Cottonwood, Arizona

## **CITY OF COTTONWOOD MISSION AND VISION STATEMENTS**

### **Mission Statement**

The City of Cottonwood, through ethical, accountable, professional leadership and collaboration, enhances quality of life for our diverse community while preserving our unique environment and character.

### **Vision Statement**

The City of Cottonwood strives to maintain a uniquely desirable and sustainable community.

We are unique because of our people, our grand natural resources, public amenities, leadership, diversity and home town atmosphere.

We will continue to conserve, preserve and manage our precious resources, including the Verde River and its unique riparian habitat.

We will enhance our position as the economic center for the Verde Valley, providing retail, medical, education, transportation, recreation and tourism.

The City of Cottonwood provides leadership and solutions to ensure a prosperous community where a diversity of people and nature thrive.

# CITY OF COTTONWOOD PROFILE<sup>1</sup>

## Regional Setting

The Verde Valley includes about 714 square miles located in the geographic center of Arizona, about 100 miles north of the Phoenix metropolitan area. The Verde River runs through the valley from northwest to southeast and is augmented by flows from Sycamore Canyon, Oak Creek, Beaver Creek and West Clear Creek. The area is unsurpassed in its variety of physical beauty with the red rocks and Mogollon Rim to the north and east and the Black Hills and Mingus Mountain dominating the western and southern portions of the valley.



The City of Cottonwood is located adjacent to the Verde River at elevations ranging from 3,300 feet to 3,900 feet above sea level and experiences a mild climate which, together with its proximity to an abundance of natural amenities such as the Grand Canyon, Sedona, Dead Horse Ranch State Park, Tuzigoot National Monument and the historic mining communities of Clarkdale and Jerome, continues to attract steady growth and tourism.

## Early History

As with other communities in the Verde Valley, the City shares a rich and lengthy history. The region has long been home to Native Americans, particularly the Sinagua and later the Yavapai and Apache. The first Anglo settlers in the area farmed and provided goods for the soldiers at Camp Verde and for the miners in Jerome beginning in the late 1870's. William Clark and Jimmy Douglas developed major smelters and the mining communities of Clarkdale (1912) and Clemenceau (1917), respectively. Clemenceau located near the intersection of Willard Street and Mingus Avenue was a complete company town with thousands of residents, a school and other community facilities. Today, few people recognize the size and complexity of the original "Smelter City".

During this period, mining companies that closely regulated commerce, industry, employment and even housing opportunities administered Jerome, Clarkdale and Clemenceau.

Old Town Cottonwood became a haven for those seeking to be free from the prejudice and regulation of nearby company towns. Main Street was created in 1908 when Charles Stemmer and Alonzo Mason used a mule team to pull and drag through brush. The Mason Addition, Willard Addition, Hopkins Ranch No. 2 and other tracts were platted during the

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<sup>1</sup> Information for this profile was taken from the City of Cottonwood website - [www.cottonwoodaz.gov](http://www.cottonwoodaz.gov)

next decade coinciding with the development of Clemenceau on higher ground about one mile to the south.

The Clemenceau smelter closed on December 31, 1936 with a great loss of jobs and disruption to the area's economy. The Cottonwood Women's Club organized to feed those in need and raised money to build the Cottonwood Civic Center (1939) with labor provided through the Works Progress Administration. The copper industry continued its decline culminating with the closure of the Phelps Dodge operation in the 1950's. Population plummeted in the region as the mining industry declined. Jerome's population declined from about 8,000 to nearly 0, while Clarkdale went from nearly 4,000 to several hundred.

## **Recent History**

The City of Cottonwood incorporated in 1960. During this period area roads were improved, particularly the Highway 89A "Bypass" and SR 260 to serve the needs of the Phoenix Cement Plant located in Clarkdale. This facility supplied the cement for the Glen Canyon Dam project near Page. During the early 1970's about 4,500 lots were platted outside the Cottonwood City Limits by Ned Warren - the Queen Creek Land & Cattle Company. These lots, known as Verde Village, have limited infrastructure but have been built upon over time and few vacant parcels remain today. With road development and an increasingly large residential base, commercial development moved south from Old Town to SR89A intersections at Main Street and at SR260 during the 1970's and 1980's.

In 1990, the City constructed a wastewater treatment plant and collection system, the first in the Verde Valley. This plant was expanded in 2000 to treat 1.5 million gallons per day and allow discharge of reclaimed water into Del Monte Wash. The availability of a modern sanitary sewer system has assisted the City to attract and accommodate growth.

Since 2001 the City has pursued the acquisition of the private water companies serving the area. Between 2004 and 2006 those acquisitions came to fruition and the City of Cottonwood became a full service municipality.

Cottonwood has experienced a major expansion of the Verde Valley Medical Center,



development of new residential projects such as Cottonwood Ranch and many commercial and office projects. More recent improvements include the expansion of the Public Library nearly doubling its size as well as the opening of the 56,000 sq. ft. Cottonwood Recreation Center providing state of the art fitness equipment and additional indoor recreation opportunities.

## City Government

The City of Cottonwood operates under a Council–Manager form of government. The Council consists of a Mayor, Vice Mayor, and five Council members. The City Manager reports to the Mayor, Council and the citizens of Cottonwood. There are three General Managers that assist the City Manager with the responsibility for the day-to-day operation of the City. Any and all changes to the City’s Water and Wastewater rates and its structure must be approved by a vote of the City Council.

<b>City of Cottonwood Officials</b>	
<u>Mayor &amp; Council</u>	<u>Senior City Staff</u>
Diane Joens, Mayor	Douglas Bartosh, City Manager
Karen Pfeifer, Vice-Mayor	Rudy Rodriguez, Administrative Services General Manager
Tim Elinski, Council Member	Dan Lueder, Developmental Services General Manager
Jesse Dowling, Council Member	Richard Faust, Community Services General Manager
Randy Garrison, Council Member	
Ruben Jauregui, Council Member	
Terence Pratt, Council Member	

The City utilizes Generally Accepted Accounting Principles (GAAP) for its governmental as well as its proprietary funds. Cottonwood also has a July 1<sup>st</sup> through June 30<sup>th</sup> fiscal year.

## Weather<sup>2</sup>

Moderate weather makes Cottonwood an excellent place to visit year round.

<u>Month</u>	<u>Average Daily Temperature (F)</u>		<u>Average Total Precipitation (inches)</u>
	<u>Maximum</u>	<u>Minimum</u>	
January	58.1	28.1	0.8
February	63.3	31.7	0.8
March	68.3	35.6	0.9
April	76.6	41.9	0.5
May	84.8	49.2	0.4
June	94.8	57.8	0.5
July	98.5	65.9	1.9
August	95.5	63.8	2.2
September	91.3	57.4	1.1
October	81.2	46.4	1.0
November	68.1	35.6	0.7
December	58.6	28.7	1.1
Annual Average	78.2	45.2	1.0

<sup>2</sup> Source: Arizona Department of Commerce – Community Profile for Cottonwood, AZ and Western Regional Climate Center

## PURPOSE OF THIS RATE STUDY

The primary purpose of this Water and Wastewater Rate Study is to develop multi-year financial projections for the City of Cottonwood Water and Wastewater Utilities, and to establish the maintenance and operational rates at a level related to the total cost of providing those services.

On August 16, 2011, the City of Cottonwood City Council met with City Staff to begin preliminary discussions about possible rate adjustments to the two City utilities, water & wastewater. That presentation, provided by the City staff, centered on the various economic issues specifically facing the Water Utility owned by the City of Cottonwood. However, since many of the same issues affect the both utilities, this report will include the Water and Wastewater Utilities.

The economic problems facing the area, unemployment, foreclosures, and lack of growth have affected the two system's ability to continue to thrive by reducing its ability to fund reserves, and borrow money for future projects. These same economic factors have adversely impacted the debt service coverage ratio imposed by covenant in the Cottonwood Municipal Property Corporation Senior Lien Water System Revenue Bonds, Series 2004 and Series 2006 – MPC Bonds. Current requirements are that the City should maintain a 1.35:1x debt service coverage ratio. This debt service coverage deterioration has prompted Moody's Rating Service to downgrade the City's MPC Bonds.<sup>3</sup>

With the gradual decline of the debt service coverage ratio and the subsequent lowering of the City's water bond rating; the City has initiated measures to correct the deficiencies and provide a long term roadmap to fiscal viability of both the Water and Wastewater Utilities.

Part of the corrective measures to counter the negative effects of the downgrade and the economic decline is to conduct and complete a rate study and subsequent report comprehensively updating the City's rate analysis conducted by Economists.com in 2009. Some of the following issues will be considered when establishing the various rate options:

-  Cost of service,
-  Conservation of water resources using a tier rate structure, and
-  Fiscal performance measurements to ensure all bond covenants are adequately met and sufficient cash reserves are available for major repairs and replacement.

Any proposed increases to service and treatment rates must consider the following principles:

-  Adequacy – any rate increase should be adequate to recover the full cost of operations and administration;
-  Efficient – rates should be designed for easy, low-cost administration and compliance with all customers paying the said rates; and
-  Straightforwardness – rates should be easily understood by all customers limiting the opportunity of subjective interpretations.

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<sup>3</sup> Appendix A - News Release - Moody's Ratings Update

## SCOPE OF STUDY

The City Staff and Council have identified several objectives that shall be included in this study, including but not limited to the following:

-  Analysis of the historic and current cost of service and revenue requirements for both the Water and Wastewater Utilities
-  Forecast operating expenses over the next five years, taking into consideration such factors as the local economy, inflation, system growth, and increased staffing levels requirements.
-  Project future accounts, volumes and billing units for the five year forecast.
-  Review future Water and Wastewater capital infrastructure requirements, as well as narrowing down the financing options available.
-  Develop a rate structure that encourages conservation and discourages waste.
-  Review available options and narrow down to a recommendation:
  - Using the current tiered rate structure
  - Using an expanded tiered rate structure
  - Rate differentials between commercial, residential and multi-residential
  - Rate differentials for customers located inside and outside of the corporate City limits
  - A gradual adjustment over several years to eventually meet our covenants
  - An across the board increase to all classes to meet the debt services covenants
-  Evaluate various rate structure options to comply with the debt service coverage covenants imposed by the City's 2004 & 2006 MPC Bonds, and bring a recommendation to the Council.

## BACKGROUND

### Water

Another historic period for the City of Cottonwood was entering into the water business on October 1, 2004 with the purchase of three area water companies; Verde Santa Fe, Clemenceau, and the Cordes Lakes Water Systems for a price tag of \$13,580,000. Less than two short years later the City acquired one of the largest systems in the area, the Cottonwood Water Works System for \$23,965,000.



Part of the original 2004 projections for the system was

Current Rate Structure	
<u>Percent Adjustment</u>	
<u>Base Charge</u>	
5/8"	\$18.36
1"	\$30.24
1 1/2"	\$61.56
2"	\$97.20
3"	\$194.40
4"	\$302.40
6"	\$615.60
<u>Volume Charge (per 1,000 gal)</u>	
0 – 1,000	
1,001 – 4,000	\$2.90
4,001 - 10, 000	\$3.19
10001 – 20,000	\$4.55
20,000 +	\$6.48
<u>Water Resource Development Fee</u>	
Water Resource Development	\$4.32
Water Assurance	\$0.35
Gila River Adjudication	\$0.44
Water Conservation	\$0.27
<u>Total Development Fee</u>	<u>\$5.38</u>

to increase rates in November 2005 and November 2007. Both were postponed with the acquisition of the Cottonwood Water Works System. Additional increases were also planned for November 2010 through and November 2015. Unfortunately, the only increase since Cottonwood entered the water business was in September 2010. The increase was 8% increase and a change in the tiered volume structure to accommodate small water users.

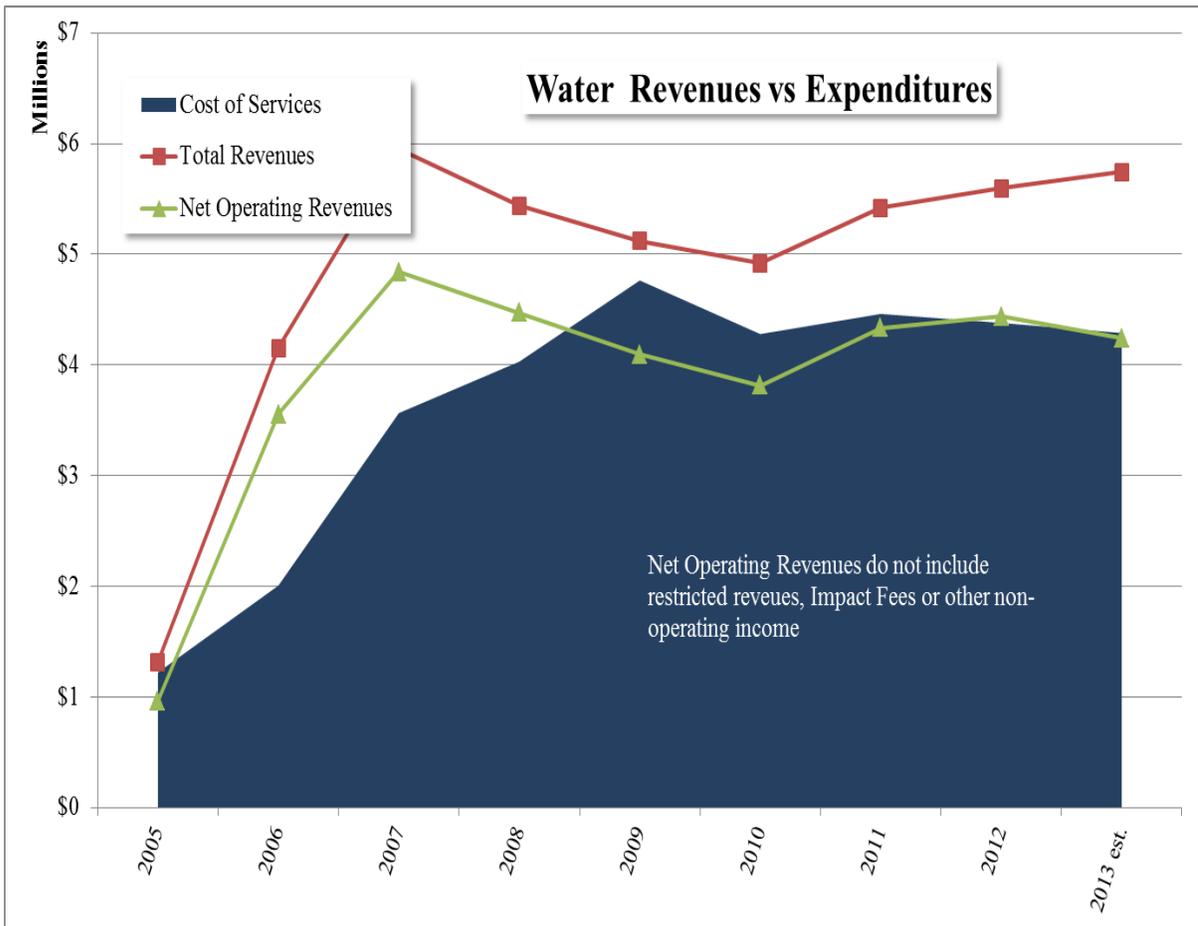
Concerns continue to mount as more issues become apparent that affect the System directly as well as indirectly. Item such as rising costs, as well as meeting stringent water standards continue to place extreme pressures on the current rate structure.

The table on the left presents the City's current water rate structure in place since October 2010:

Monthly service charges are based on 1,000 gallons of usage. Volume charges are based on the schedule included on the previously page and prorated to actual usage. Resource Development Fees are a fixed amount on all billings.

Below is an illustration of the user fees, cost of services and total revenues by the Water Utility since it was placed into service as it exists today. The system is an enterprise fund and should be run as a business. As such it has its own revenue sources and should be self-sufficient.

Unlike the Wastewater Utility, this Utility has two bonds which have specific covenants that require the City of Cottonwood to generate enough revenues to not only cover its operations and maintenance cost, but also provide a minimum of a 1.35X debt service coverage.



This Water Utility has various sources of revenue besides user fees to draw from, such as interest income. Unfortunately, returns on City investment have been less than stellar as there has been a heavy deterioration in interest rates along with the decline in reserves. Fiscal year 2007 had one of the highest return rates we have seen in nearly a decade topping out a nearly 5.3%. This high interest rate along with the purchase of the Cottonwood Water Company and its bonding for system improvements caused a spike in revenues in fiscal year 2007. Rate of returns have slowly waned over the years.

## Wastewater

The decision to build a sanitary sewer system (Wastewater System) for the City of Cottonwood began after some planning and a meeting on March 24, 1987 calling for an election seeking three things:

1. The construction of a sanitary sewer system to be owned by the City of Cottonwood,
2. Provisions for the issuance and sale of bonds to construct, improve, operate and maintain a sanitary sewer system, and
3. Increase the City's transaction privilege tax (sales tax) by 1% to provide funds for the construction, improvement, operation and maintenance of a City owned sanitary sewer system.



An election was held on April 28, 1987 on the aforementioned three topics with the results all being in favor of the City constructing a sanitary sewer system. On May 5, 1987 there was a canvassing of election results making it official, Cottonwood was getting into the sewer business.

In the 24 years since those historic dates, the City of Cottonwood has increased sanitary sewer, now known as wastewater, rates 5 times:

Initial 1987	\$6.75	10/01/1995	\$13.20
10/01/1991	\$10.07	10/01/2000	\$14.25
10/01/1992	\$11.40	10/01/2001	\$16.75

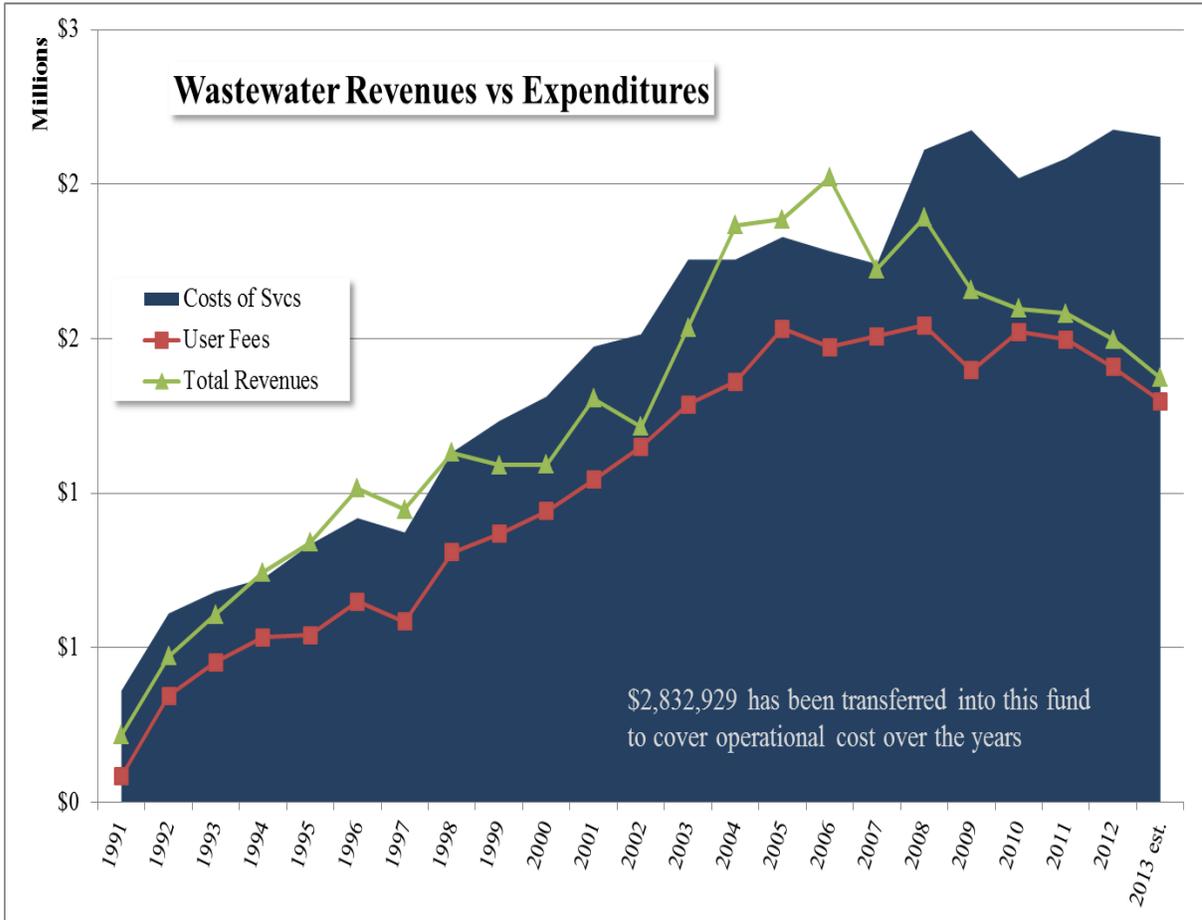
Throughout the two plus decades, the Wastewater system had support from a 1% sales tax which sunset on July 1, 2007. After that date, sales tax was no longer available for operations and maintenance of the Wastewater System and has since been using accumulated reserves to continue operations. Though the usage of reserves is minor, it is something that needs to be rectified sooner rather than later.

**Current Wastewater Rates**

Residential	Monthly Service Charge	\$16.75
Multi Residential	Monthly Service Charge (per unit)	\$16.75
Commercial	Monthly Service Charge	\$16.75
Commercial Usage Charge	Per 1,000 Gallons	\$2.60

All charges for residential and multi-residential accounts are a flat monthly wastewater rate and don't carry any additional usage charge. Commercial accounts pay the \$16.75 flat monthly rate plus an additional \$2.60 per 1,000 gallons of water usage.

Below is an illustration of the user fees, cost of services and total revenues by the Wastewater Utility since it was placed into service. The System is an enterprise fund and should be run as a business. It has its own revenue sources and should be self-sufficient; however, since the loss of the sales tax to support the fund, it has been running at a deficit and has used accumulated reserves to continue its operations to date.



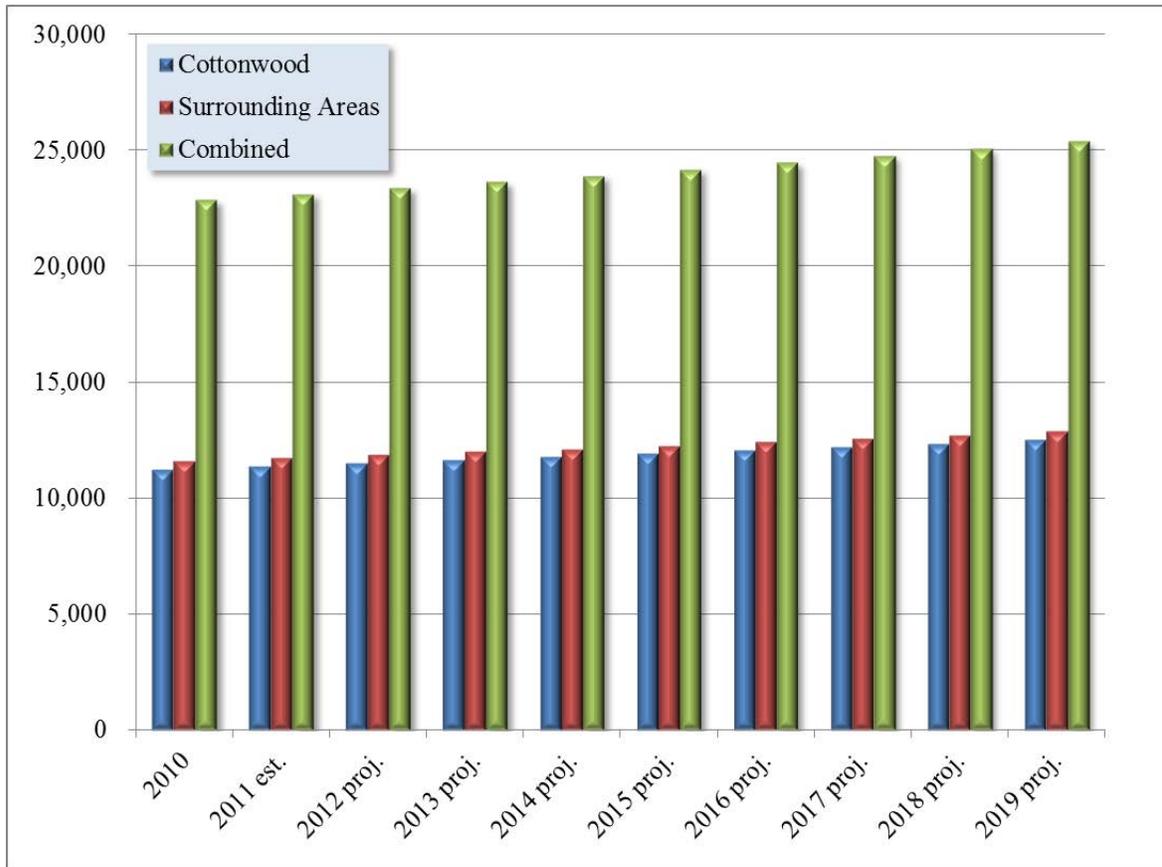
Currently, this System does not have any debt service. The Utility, however is showing its age and is in need of some major repairs which are contemplated in this study.

## ASSUMPTIONS

### Population Data

Despite the growth rates of the past, this study takes a very conservative approach to the community's growth with an average of slightly more than a 1% growth per year using the 2010 census year as a base year. Please note that this illustration depicts both the populations within the corporate limits of the City of Cottonwood as well as the population outside the City corporate limits. The Water Utility services areas outside its boundaries such as Bridgeport, the Verde Villages, and Verde Santa Fe.

Calendar Year	Population		
	Cottonwood	Surrounding Areas	Combined
2010	11,265	11,605	22,870
2011 est.	11,392	11,736	23,128
2012 proj.	11,521	11,869	23,390
2013 proj.	11,651	12,003	23,654
2014 proj.	11,783	12,139	23,922
2015 proj.	11,916	12,276	24,192
2016 proj.	12,059	12,423	24,482
2017 proj.	12,204	12,572	24,776
2018 proj.	12,350	12,723	25,073
2019 proj.	12,523	12,901	25,424



## Projected Water Usage

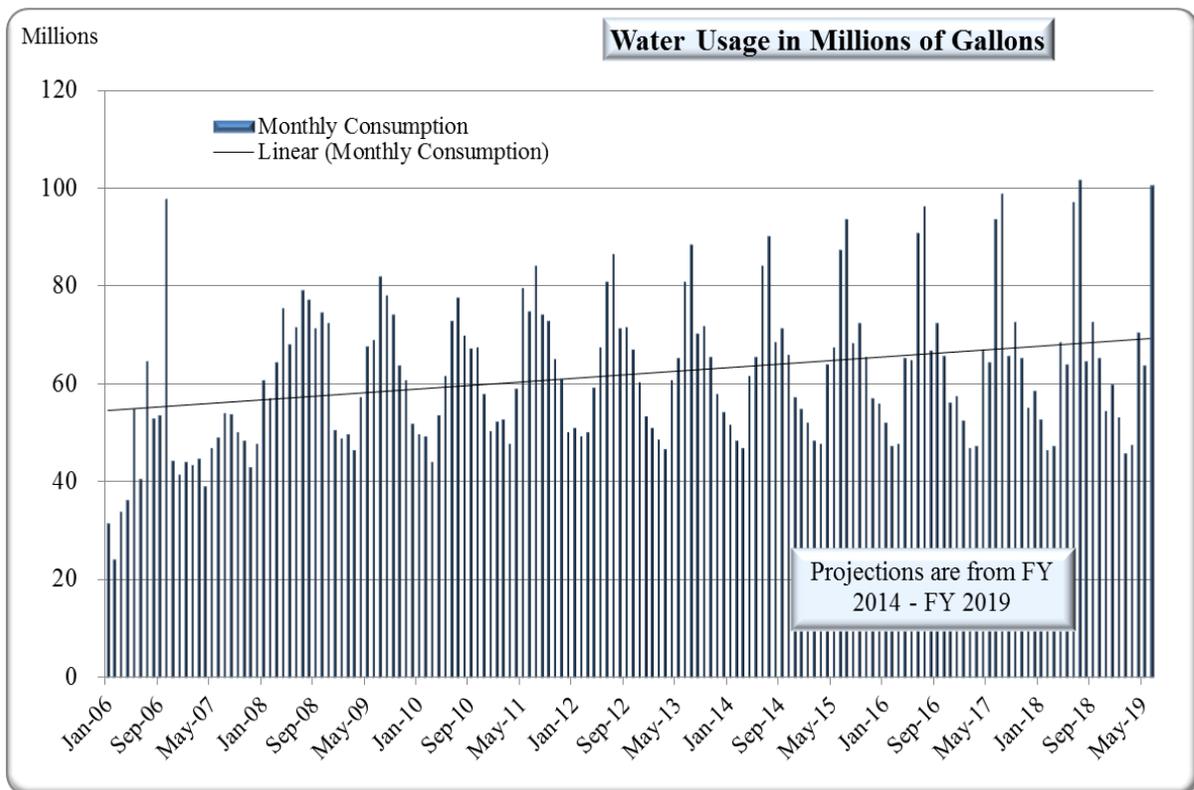
The City of Cottonwood Municipal Water Utility now tracks monthly water usage by the various cycles and by month. This is helpful in understanding the community's usage patterns, in order to improve system and utility's service capabilities. The first couple of

Fiscal Year	Annual Consumption	inc. / (dec.)
2007	621,788,315	
2008	693,762,525	11.58%
2009	764,102,212	10.14%
2010	741,502,903	-2.96%
2011	756,472,785	2.02%
2012	764,884,941	1.11%
2013 est.	763,489,440	-0.18%
2014 proj.	766,384,544	0.38%
2015 proj.	774,937,097	1.12%
2016 proj.	781,205,949	0.81%
2017 proj.	786,106,678	0.63%
2018 proj.	792,543,193	0.82%
2019 proj.	799,873,811	0.92%

years the Water Utility struggled to get a handle on all of the meters that needed to be replaced due to faulty low readings. Since that time most, if not all, of the faulty meters have been replaced and are periodically checked for accuracy.

With more accurate meters it has become apparent that usage levels have been on the rise slightly. The trend is very slight and for the purpose of this study we are projecting minimal growth through fiscal year 2019.

One big factor to water usage is the weather. This is not taken into account for this report.



## PROJECTIONS FOR FY 2013 – 2019

### Water

The projections depicted in the chart below take into consideration the projected rates being proposed. Note that it is critical that the Water Utility increase its rates to meet the minimum bond covenant requirements. Afterwards it may take two to three years before the City of Cottonwood is able to get their bonds upgraded; giving the City the ability to approach the bond market for capital improvement funding.

	ESTIMATED	PROJECTED					
	2013	2014	2015	2016	2017	2018	2019
<b>Sources of Revenue</b>							
<b>Operating Revenues</b>							
User Fees	\$5,150,500	\$6,546,282	\$6,709,940	\$7,565,459	\$7,754,600	\$7,948,470	\$8,147,180
Reimbursements From Clarkdale	312,120	312,120	319,920	327,920	336,120	344,520	353,130
Meter Installation Charge	6,600	6,770	6,940	7,110	7,290	7,470	7,660
Service Turn Ons	58,300	59,760	61,250	62,780	64,350	65,960	67,610
Collections / Late Fees	76,075	77,980	79,930	81,930	83,980	86,080	88,230
Other Income	142,000	10,000	10,250	10,510	10,770	11,040	11,320
<b>Operating Revenues</b>	<b>\$5,745,595</b>	<b>\$7,012,912</b>	<b>\$7,188,230</b>	<b>\$8,055,709</b>	<b>\$8,257,110</b>	<b>\$8,463,540</b>	<b>\$8,675,130</b>
<b>Non-operating Revenues</b>							
Interest Income	8,817	9,047	9,278	9,520	9,763	10,017	10,272
Sale of Property	3,000	5,000	5,000	5,000	5,000	5,000	5,001
Building Rental	7,615	7,810	8,010	8,210	8,420	8,630	8,850
<b>Non-operating Revenues</b>	<b>\$19,432</b>	<b>\$21,857</b>	<b>\$22,288</b>	<b>\$22,730</b>	<b>\$23,183</b>	<b>\$23,647</b>	<b>\$24,123</b>
<b>Revenues Available</b>	<b>\$5,765,027</b>	<b>\$7,034,769</b>	<b>\$7,210,518</b>	<b>\$8,078,439</b>	<b>\$8,280,293</b>	<b>\$8,487,187</b>	<b>\$8,699,253</b>
<b>Expenses</b>							
Personnel	\$1,090,470	\$1,207,238	\$1,270,600	\$1,333,820	\$1,400,410	\$1,470,090	\$1,543,270
Operating Supplies	379,575	397,330	417,470	438,560	460,700	483,910	508,260
Contractual Services	133,535	138,720	147,780	154,670	161,910	169,510	177,490
Other Services and Charges	1,700,680	1,758,135	1,843,540	1,933,400	2,028,240	2,127,290	2,231,310
Equipment Purchases	10,000	169,570	78,500	98,500	43,000	65,000	0
<b>Total Operating Expenses</b>	<b>3,314,260</b>	<b>3,670,993</b>	<b>3,757,890</b>	<b>3,958,950</b>	<b>4,094,260</b>	<b>4,315,800</b>	<b>4,460,330</b>
<b>Income or (Loss)</b>	<b>2,450,767</b>	<b>3,363,776</b>	<b>3,452,628</b>	<b>4,119,489</b>	<b>4,186,033</b>	<b>4,171,387</b>	<b>4,238,923</b>
<b>Debt Service</b>							
Debt Service P&I	2,500,550	2,484,315	2,521,180	2,987,910	3,054,115	3,050,400	3,050,400
DS Coverage - 35%	875,193	869,510	882,414	1,045,768	1,068,940	1,067,640	1,067,640
<b>Total Debt Service Needed</b>	<b>\$3,375,743</b>	<b>\$3,353,825</b>	<b>\$3,403,594</b>	<b>\$4,033,678</b>	<b>\$4,123,055</b>	<b>\$4,118,040</b>	<b>\$4,118,040</b>
	<b>98.0%</b>	<b>135.4%</b>	<b>136.9%</b>	<b>137.9%</b>	<b>137.1%</b>	<b>136.7%</b>	<b>139.0%</b>
<b>Other Financing Sources</b>							
Bonds	\$0	\$0	\$5,000,000	\$0	\$0	\$0	\$0
Transfers In-CIP Fund	0	0	0	0	0	0	0
<b>Total Other Financing Sources</b>	<b>\$0</b>	<b>\$0</b>	<b>\$5,000,000</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>
<b>Capital Improvements</b>							
Capital Improvement	\$2,060,660	\$3,084,000	\$795,200	\$1,226,460	\$797,783	\$899,172	\$800,631
<b>Total Capital Improvements</b>	<b>(\$2,060,660)</b>	<b>(\$3,084,000)</b>	<b>\$4,204,800</b>	<b>(\$1,226,460)</b>	<b>(\$797,783)</b>	<b>(\$899,172)</b>	<b>(\$800,631)</b>

Water capital improvements are focused on maintaining and improving the City’s current infrastructure as well as extending lines throughout the City’s SR 260 corridor. The SR 260 corridor project has been in the works for several years and would open up some great opportunities for the City of Cottonwood by having more commercial properties available for businesses.

The Water Utility also continues to improve fire suppression throughout the entire system by strategically locating fire hydrants as well as improving water quality through arsenic mitigation and improved pumping capabilities.

CAPITAL PROJECTS	ESTIMATED	PROJECTED					
	2013	2014	2015	2016	2017	2018	2019
Legal Advertising	-	-	-	-	-	-	-
Investment Expense	-	24,000	25,200	26,460	27,783	29,172	30,631
Arsenic Mitigation	500,000	500,000	250,000	250,000	250,000	250,000	250,000
Aid in Lieu of Construction	-	-	-	-	-	-	-
Well Booster Station	500,660	250,000	-	100,000	-	100,000	-
Line Extensions	-	-	-	-	-	-	-
Water System Upgrades	170,000	170,000	170,000	500,000	170,000	170,000	170,000
Well Improvements	100,000	150,000	100,000	100,000	100,000	100,000	100,000
Fire Hydrant Improvements	500,000	500,000	250,000	250,000	250,000	250,000	250,000
SR 260 System Upgrades	-	1,250,000	-	-	-	-	-
W. Mingus Constructions	130,000	-	-	-	-	-	-
12th Street 89A to Fir Waterline Improvements	160,000	240,000	-	-	-	-	-
<b>Annual Capital Improvements Needs</b>	<b>2,060,660</b>	<b>3,084,000</b>	<b>795,200</b>	<b>1,226,460</b>	<b>797,783</b>	<b>899,172</b>	<b>800,631</b>

The debt service detailed below takes into account the possibility of a \$5,000,000 bond issue late in FY 2015 to continue improvements to the system in and out of the corporate City limits. With the additional debt service, the City will need to maintain additional funds to cover any debt service bond covenants as is the current situation.

DEBT SERVICE	ESTIMATED	PROJECTED					
	2013	2014	2015	2016	2017	2018	2019
<b>Debt Service</b>							
2004 MPC Bond thru 2029	954,480	953,995	963,210	963,215	967,140	964,860	964,860
2006 MPC Bond thru 2035	1,546,070	1,530,320	1,557,970	1,544,695	1,606,975	1,605,540	1,605,540
2015 Issue thru 2030	-	-	-	480,000	480,000	480,000	480,000
<b>Total Debt Service</b>	<b>2,500,550</b>	<b>2,484,315</b>	<b>2,521,180</b>	<b>2,987,910</b>	<b>3,054,115</b>	<b>3,050,400</b>	<b>3,050,400</b>
<b>Coverage</b>							
2004 MPC Bond thru 2029	334,068	333,898	337,124	337,125	338,499	337,701	337,701
2006 MPC Bond thru 2035	541,125	535,612	545,290	540,643	562,441	561,939	561,939
2015 Issue thru 2030	0	0	0	168,000	168,000	168,000	168,000
<b>Total Coverage Requirement</b>	<b>875,193</b>	<b>869,510</b>	<b>882,414</b>	<b>1,045,768</b>	<b>1,068,940</b>	<b>1,067,640</b>	<b>1,067,640</b>
<b>Total DS &amp; Coverage Requirement</b>	<b>3,375,743</b>	<b>3,353,825</b>	<b>3,403,594</b>	<b>4,033,678</b>	<b>4,123,055</b>	<b>4,118,040</b>	<b>4,118,040</b>

## Wastewater

The projections depicted in the chart below take into consideration the projected rates being proposed. It is not as critical that the Wastewater Utility rate increase dramatically as it is with the Water Utility. This is due to not having any debt load at this time, thus no minimum bond covenant requirements. The rates being proposed have been smoothed out over the five year period beginning FY 2014. This was done to prevent a large spike in the rates this coming year.

Also included in the projections are the costs for the Riverfront Water Reclamation Facility projected to be operational mid to late FY 2014. A full year's costs are calculated into FY 2015. This plant, once fully operational, may provide some efficiency that may curb future costs. This will be reviewed in the future once the plant has been operating for a couple of years.

	ESTIMATED	PROJECTED					
	FY 2013	FY 2014 <sub>1</sub>	FY 2015 <sub>2</sub>	FY 2016	FY 2017	FY 2018	FY 2019
User Fees	\$1,257,638	\$1,970,971	\$2,050,598	\$2,112,116	\$2,167,031	\$2,230,958	\$2,330,905
Other Income	39,640	40,840	42,070	43,340	44,640	45,990	47,370
<b>Operating Revenues</b>	<b>\$1,297,278</b>	<b>\$2,011,811</b>	<b>\$2,092,668</b>	<b>\$2,155,456</b>	<b>\$2,211,671</b>	<b>\$2,276,948</b>	<b>\$2,378,275</b>
<b>Non-operating Revenues</b>							
Interest Income	15,260	15,640	16,030	16,430	16,840	17,260	17,690
Capacity Fees	60,000	61,800	63,650	65,560	67,530	69,560	71,650
Sale of Property	0	0	0	0	0	0	0
Building Rental	0	0	0	0	0	0	0
<b>Non-operating Revenues</b>	<b>75,260</b>	<b>77,440</b>	<b>79,680</b>	<b>81,990</b>	<b>84,370</b>	<b>86,820</b>	<b>89,340</b>
<b>Revenues Available</b>	<b>\$1,372,538</b>	<b>\$2,089,251</b>	<b>\$2,172,348</b>	<b>\$2,237,446</b>	<b>\$2,296,041</b>	<b>\$2,363,768</b>	<b>\$2,467,615</b>
<b>Expenses</b>							
Personnel	\$641,650	\$707,875	\$768,160	\$808,550	\$851,120	\$895,980	\$943,270
Operating Supplies	222,145	233,400	256,060	268,890	282,330	296,450	311,280
Contractual Services	114,925	127,865	140,020	147,030	154,390	162,130	170,240
Other Services and Charges	672,310	698,045	756,620	794,470	834,220	875,940	919,760
Equipment Purchases	34,500	9,000	84,000	15,000	37,500	54,000	0
<b>Total Operating Expenses</b>	<b>1,685,530</b>	<b>1,776,185</b>	<b>2,004,860</b>	<b>2,033,940</b>	<b>2,159,560</b>	<b>2,284,500</b>	<b>2,344,550</b>
Income or (Loss)	(312,992)	313,066	167,488	203,506	136,481	79,268	123,065
<b>Debt Service</b>							
	ESTIMATED	PROJECTED					
	FY 2013	FY 2014 <sub>1</sub>	FY 2015 <sub>2</sub>	FY 2016	FY 2017	FY 2018	FY 2019
Debt Service P&I	0	0	240,000	240,000	624,000	624,000	624,000
DS Coverage - 35%	0	0	84,000	84,000	218,400	218,400	218,400
<b>Total Debt Service</b>	<b>0</b>	<b>0</b>	<b>324,000</b>	<b>324,000</b>	<b>842,400</b>	<b>842,400</b>	<b>842,400</b>
<b>Other Financing Sources</b>							
	ESTIMATED	PROJECTED					
	FY 2013	FY 2014 <sub>1</sub>	FY 2015 <sub>2</sub>	FY 2016	FY 2017	FY 2018	FY 2019
Bonds	0	2,500,000	0	4,000,000	0	0	0
Transfers In-CIP Fund	0	4,500,000	4,000,000	0	0	0	0
<b>Total Other Financing Sources</b>	<b>0</b>	<b>7,000,000</b>	<b>4,000,000</b>	<b>4,000,000</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Capital Improvements</b>							
Capital Improvement	467,900	5,553,450	6,207,960	695,090	327,330	714,680	350,140
<b>Total Capital Improvements</b>	<b>(467,900)</b>	<b>1,446,550</b>	<b>(2,207,960)</b>	<b>3,304,910</b>	<b>(327,330)</b>	<b>(714,680)</b>	<b>(350,140)</b>

Wastewater capital improvements are also focused on maintaining and improving the City's current infrastructure as well as extending lines throughout the City's SR 260 corridor. There is also a need to install reclaimed water lines to provide reclaimed water to parks, schools, and possibly the public in the future.

CAPITAL PROJECTS	ESTIMATED	PROJECTED					
	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
LEGAL ADVERTISING	\$500	\$520	\$540	\$560	\$580	\$600	\$620
INVESTMENT EXPENSE	400	410	420	430	440	450	460
260-DESIGN	40,000	0	0	0	0	0	0
260-CONSTRUCTION	0	0	1,900,000	0	0	0	0
LINE EXTENSIONS	130,000	136,500	0	150,000	0	165,000	0
CONSTRUCTION WWTP	0	4,500,000	4,000,000	0	0	0	0
LIFT STATION	150,000	0	165,000	0	180,000	0	198,000
RECL H2O PUMP SYSTEM UPGRADE	0	40,000	42,000	44,100	46,310	48,630	51,060
CONSTRUCTION - GENERAL	90,000	500,000	0	500,000	0	500,000	0
WWTP UPGRADES	0	0	100,000	0	100,000	0	100,000
12th Street: Fir-89A Reclamation Lines	0	376,020	0	0	0	0	0
PARKING LOT RECONSTRUCTION	57,000	0	0	0	0	0	0
<b>Annual Capital Improvement Needs</b>	<b>\$467,900</b>	<b>\$5,553,450</b>	<b>\$6,207,960</b>	<b>\$695,090</b>	<b>\$327,330</b>	<b>\$714,680</b>	<b>\$350,140</b>

The debt service detailed below takes into account the possibility of a \$2,500,000 bond issue late in FY 2014 and a \$4,000,000 issue in FY 2016 to continue improvements to the System in and out of the corporate City limits. As with the Water Utility, with any future debt service there will be the need to maintain additional funds to cover any debt service bond covenants.

Debt Service	ESTIMATED	PROJECTED					
	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019
2014 Issue thru 2030			\$240,000	\$240,000	\$240,000	\$240,000	\$240,000
2016 Issue thru 2032					\$384,000	\$384,000	\$384,000
<b>Total Debt Service</b>	<b>\$0</b>	<b>\$0</b>	<b>\$240,000</b>	<b>\$240,000</b>	<b>\$624,000</b>	<b>\$624,000</b>	<b>\$624,000</b>
<b>Coverage</b>							
2014 Issue thru 2030			\$84,000	\$84,000	\$84,000	\$84,000	\$84,000
2016 Issue thru 2032			\$0	\$0	\$134,400	\$134,400	\$134,400
<b>Total Coverage Requirement</b>	<b>\$0</b>	<b>\$0</b>	<b>\$84,000</b>	<b>\$84,000</b>	<b>\$218,400</b>	<b>\$218,400</b>	<b>\$218,400</b>
<b>Total DS &amp; Coverage Requirement</b>	<b>\$0</b>	<b>\$0</b>	<b>\$324,000</b>	<b>\$324,000</b>	<b>\$842,400</b>	<b>\$842,400</b>	<b>\$842,400</b>

## WATER AND WASTEWATER RATE PROJECTIONS

### Water

The Water Utility rates proposed provide for a different rate for those inside and outside the City corporate boundaries. The rate committee struggled with this decision and ultimately came to the conclusion that it was the best option for the City of Cottonwood based on several factors:

-  The distances are far greater when servicing lines as well as pumps and other equipment outside the corporate limits.
-  The terrain in much of the Verde Villages is very different than that inside the City limits which makes repairs more costly.
-  The Cottonwood Municipal Water Utility is a public utility owned by the citizens of Cottonwood. When the Utility borrows money for infrastructure, whether inside or outside the City limits, the citizens of Cottonwood bear the risk of the new debt and infrastructure.
-  Inside the City, about 70% of the distribution system is fed by gravity versus booster pump. This means that the electrical cost to provide water within the City limits is significantly less per account because the only electrical cost is for the well pumpage into the gravity system. The Verde Village system and Verde Santa Fe (VSF) are 100% pressure distribution systems thus requiring a substantial amount of electricity to operate..
-  Approximately 60% of the leaks that the City repairs are in the County (mainly the Villages since VSF is a relatively new system) and Staff has to deal with three 7200 volt direct bury APS electrical lines that are joint trenched with the water lines whenever they dig there.
-  The meters in the Villages are primarily in small overgrown backyard easements which makes meter reading significantly more labor intensive.
-  There are more small wells (14) outside the City limits as opposed to larger wells inside the City limits (7); all require daily monitoring and regular maintenance regardless of size.
-  There are thirteen arsenic systems outside the limits as opposed to seven arsenic systems inside the corporate boundaries. Each of these systems require regular maintenance regardless of the size of the well.
-  The leak repair figures outside the City limits used to be higher until the City invested in new pumps and variable speed controllers in the Villages. This has reduced the pressure variations, associated water hammer, and reducing the amount of leaks.
-  The City purchased the Quail Canyon Water system exclusively to service Verde Village #6 & #7 at a cost of \$889,107
-  The Quail Canyon system will cost the City over \$200k to run the lines, including pumps and other equipment to VV #6 & #7

There was a minor change in the tiers to accommodate low usage and low income customers and shift cost to higher users:

<u>Volume Charge (per 1,000 gal)</u>	<u>Volume Charge (per 1,000 gal)</u>
0 – 1,000	0 – 1,000
1,001 – 4,000	1,001 – 5,000
4,001 - 10, 000	5,001 - 10, 000
10,001 – 20,000	10,001 – 15,000
20,000 +	15,000 +

The following tables reflect current, proposed and projected rates through FY 2019.

INSIDE CORPORATE CITY LIMIT RATE PROJECTIONS

Base Charge	CURRENT	PROPOSED	PROJECTED				
	2013	2014	2015	2016	2017	2018	2019
5/8"	\$18.36	\$23.36	\$23.83	\$24.31	\$24.80	\$25.30	\$25.81
1"	\$30.24	\$37.80	\$38.56	\$39.33	\$40.12	\$40.92	\$41.74
1 1/2"	\$61.56	\$76.95	\$78.49	\$80.06	\$81.66	\$83.29	\$84.96
2"	\$97.20	\$121.50	\$123.93	\$126.41	\$128.94	\$131.52	\$134.15
3"	\$194.40	\$243.00	\$247.86	\$252.82	\$257.88	\$263.04	\$268.30
4"	\$302.40	\$378.00	\$385.56	\$393.27	\$401.14	\$409.16	\$417.34
6"	\$615.60	\$769.50	\$784.89	\$800.59	\$816.60	\$832.93	\$849.59
<u>Volume Charge (per 1,000 gal)</u>							
0 – 1,000	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
1,001 – 5,000	\$2.90	\$2.90	\$2.96	\$3.02	\$3.08	\$3.14	\$3.20
5,001 - 10, 000	\$3.19	\$3.99	\$4.07	\$4.15	\$4.23	\$4.31	\$4.40
10,001 – 15,000	\$4.55	\$5.69	\$5.80	\$5.92	\$6.04	\$6.16	\$6.28
15,000 +	\$6.48	\$8.10	\$8.26	\$8.43	\$8.60	\$8.77	\$8.95
<u>Water Resource Development Fee</u>							
Water Resource Development	\$4.32	\$4.32	\$4.32	\$4.32	\$4.32	\$4.32	\$4.32
Water Source Assurance	\$0.35	\$0.35	\$0.35	\$0.35	\$0.35	\$0.35	\$0.35
Gila River Adjudication	\$0.44	\$0.44	\$0.44	\$0.44	\$0.44	\$0.44	\$0.44
Water Conservation	\$0.27	\$0.27	\$0.27	\$0.27	\$0.27	\$0.27	\$0.27
<b>Total Development Fee</b>	<b>\$5.38</b>						
Connection Fees	\$25.00	\$35.00	\$35.00	\$35.00	\$35.00	\$35.00	\$35.00

5,000 Gallons	CURRENT	PROPOSED	PROJECTED				
	2013	2014	2015	2016	2017	2018	2019
Base Fee	\$18.36	\$23.36	\$23.83	\$24.31	\$24.80	\$25.30	\$25.81
1,000 - 5,000 Rate	8.70	\$11.60	\$11.84	\$12.08	\$12.32	\$12.56	\$12.80
5,001 - 10,000 Rate	3.19	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
10,000 - 15,000 Rate	0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
15,001- Rate	0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
WRDF	5.38	\$5.38	\$5.38	\$5.38	\$5.38	\$5.38	\$5.38
	\$35.63	\$40.34	\$41.05	\$41.77	\$42.50	\$43.24	\$43.99

OUTSIDE CORPORATE CITY LIMIT RATE PROJECTIONS

Base Charge	CURRENT	PROPOSED	PROJECTED				
	2013	2014	2015	2016	2017	2018	2019
5/8"	\$18.36	\$30.37	\$30.98	\$31.60	\$32.24	\$32.89	\$33.55
1"	\$30.24	\$49.14	\$50.13	\$51.13	\$52.16	\$53.20	\$54.26
1 1/2"	\$61.56	\$100.04	\$102.04	\$104.08	\$106.16	\$108.28	\$110.45
2"	\$97.20	\$157.95	\$161.11	\$164.33	\$167.62	\$170.98	\$174.40
3"	\$194.40	\$315.90	\$322.22	\$328.67	\$335.24	\$341.95	\$348.79
4"	\$302.40	\$491.40	\$501.23	\$511.25	\$521.48	\$531.91	\$542.54
6"	\$615.60	\$1,000.35	\$1,020.36	\$1,040.77	\$1,061.58	\$1,082.81	\$1,104.47
<u>Volume Charge (per 1,000 gal)</u>							
0 – 1,000	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
1,001 – 5,000	\$2.90	\$3.77	\$3.85	\$3.93	\$4.00	\$4.08	\$4.16
5,001 - 10, 000	\$3.19	\$5.19	\$5.29	\$5.40	\$5.50	\$5.60	\$5.72
10,001 – 15,000	\$4.55	\$7.40	\$7.54	\$7.70	\$7.85	\$8.01	\$8.16
15,000 +	\$6.48	\$10.53	\$10.74	\$10.96	\$11.18	\$11.40	\$11.64
<u>Water Resource Development Fee</u>							
Water Resource Development	\$4.32	\$4.32	\$4.32	\$4.32	\$4.32	\$4.32	\$4.32
Water Source Assurance	\$0.35	\$0.35	\$0.35	\$0.35	\$0.35	\$0.35	\$0.35
Gila River Adjudication	\$0.44	\$0.44	\$0.44	\$0.44	\$0.44	\$0.44	\$0.44
Water Conservation	\$0.27	\$0.27	\$0.27	\$0.27	\$0.27	\$0.27	\$0.27
<b>Total Development Fee</b>	<b>\$5.38</b>						
Connection Fees	\$25.00	\$45.00	\$45.00	\$45.00	\$45.00	\$45.00	\$45.00
<u>5,000 Gallons</u>							
	CURRENT	PROPOSED	PROJECTED				
	2013	2014	2015	2016	2017	2018	2019
Base Fee	\$18.36	\$30.37	\$30.98	\$31.60	\$32.24	\$32.89	\$33.55
1,000 - 5,000 Rate	8.70	\$15.08	\$15.40	\$15.72	\$16.00	\$16.32	\$16.64
5,001 - 10,000 Rate	3.19	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
10,000 - 15,000 Rate	0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
15,001- Rate	0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
WRDF	5.38	\$5.38	\$5.38	\$5.38	\$5.38	\$5.38	\$5.38
	\$35.63	\$50.83	\$51.76	\$52.70	\$53.62	\$54.59	\$55.57

Note: These projections based on the best information at the time of compilation and are subject to change.

The rate committee also considered the concept of keeping the rates the same for both inside and outside the corporate City limits. Below are the results of those calculations:

<u>Base Charge</u>	Non- Differential Rates		
	Current	Non-differential	Differential
5/8"	\$18.36	\$26.86	\$23.36
1"	\$30.24	\$45.00	\$37.80
1 1/2"	\$61.56	\$90.00	\$76.95
2"	\$97.20	\$140.00	\$121.50
3"	\$194.40	\$280.00	\$243.00
4"	\$302.40	\$435.00	\$378.00
6"	\$615.60	\$885.00	\$769.50
<u>Volume Charge (per 1,000 gal)</u>			
0 – 1,000	\$0.00	\$0.00	\$0.00
1,001 – 5,000	\$2.90	\$3.46	\$2.90
5,001 - 10, 000	\$3.19	\$4.77	\$3.99
10,001 – 15,000	\$4.55	\$6.81	\$5.69
15,000 +	\$6.48	\$9.70	\$8.10
<u>Water Resource Development Fee</u>			
Water Resource Development	\$4.32	\$4.32	\$4.32
Water Source Assurance	\$0.35	\$0.35	\$0.35
Gila River Adjudication	\$0.44	\$0.44	\$0.44
Water Conservation	\$0.27	\$0.27	\$0.27
<u>Total Development Fee</u>	<u>\$5.38</u>	<u>\$5.38</u>	<u>\$5.38</u>
Connection Fees	\$25.00	\$40.00	\$35.00
<u>R A T E S</u>			
5,000 Gallons	Current	Non-differential	Differential
Base Fee	\$18.36	\$26.86	\$23.36
1,000 - 5,000 Rate	11.60	13.84	11.60
5,001 - 10,000 Rate	0.00	0.00	0.00
10,000 - 15,000 Rate	0.00	0.00	0.00
15,001- Rate	0.00	0.00	0.00
WRDF	5.38	5.38	5.38
Monthly 5,000 Gallon Bill	<u>\$35.34</u>	<u>\$46.08</u>	<u>\$40.34</u>

After reviewing the additional burden and the factors behind differential rates, the committee consensus was to implement a differential rate program.

## Wastewater

The Wastewater Utility has a simple formula for calculating proposed rates. Below is the calculation for the FY 2014 proposed rate. Council members with some tenure have probably seen this in previous Wastewater rate increase requests.

<b>CHARGE CALCULATIONS</b>			
			<b>Recommendation</b>
			<b>\$26.25</b>
			\$26.25
<b><u>Administrative Charge</u></b>			
Formula: Administrative operating budget / # of users = cost per user / 12 months = monthly charge			
\$423,125	/	5,343	= \$79.19 / 12 = \$6.60 (cost per month)
			<b>Recommendation</b>
			<b>\$6.60</b>
			\$6.60
<b><u>Depreciation of Equipment</u></b>			
Formula: Net annual depreciation / annualized usage of gallons (in thousands) = cost per thousand			
\$543,985	/	458,943	= \$1.19 /1000 (cost per thousand)
			<b>Recommendation</b>
			<b>\$5.95</b>
			\$5.95
<b><u>Maintenance &amp; Operations (M &amp; O)</u></b>			
Formula: Net M & O operating budget / annualized usage of gallons sold (in thousands) = cost per thousand			
\$1,225,780	/	447,000	= 2.74 /1000 (cost per thousand)
<b><u>Net Maintenance &amp; Operations Budget Calculations</u></b>			
FY 2014			\$1,344,060
Less:	Miscellaneous Revenue Items (non-operational revenues)		
	Interest Income		(15,640)
	Tap Fees		(210)
	Effluent Revenue		(13,600)
	Interest Charges & Collection Fees		(27,030)
	Impact Fees		(61,800)
	Building Rental		0
	Net M & O Fee Recovery		<u>\$1,225,780</u>
			<b>Recommendation</b>
			<b>\$13.70</b>
			\$13.70

The result of the calculations is shown below along with rounding to the nearest quarter. Annual increases varied depending on the needs of the Utility. Consequently, some years have spikes rather than a gradual increase in rates as recommended by the City Council in past meetings.

Calculated Rates	ESTIMATED	PROJECTED					
	FY 2013	FY 2014 <sub>1</sub>	FY 2015 <sub>2</sub>	FY 2016	FY 2017	FY 2018	FY 2019
Administrative Rate	\$3.75	\$6.60	\$6.86	\$7.13	\$7.41	\$7.71	\$8.09
Depreciation Rate (per 1,000)	0.35	5.95	5.90	5.85	5.75	5.70	5.75
O&M Rate (per 1,000)	12.65	13.70	14.55	15.15	15.70	16.30	17.20
DS Rate	0.00	0.00	4.95	4.90	12.62	12.50	12.37
Total Monthly Residential Rate	\$16.75	\$26.25	\$32.26	\$33.03	\$41.48	\$42.21	\$43.41
Calculated Monthly Rate	\$16.75	\$26.25	\$32.26	\$33.03	\$41.48	\$42.21	\$43.41
Proposed Monthly Rate	\$16.75	\$26.25	\$32.25	\$33.00	\$41.50	\$42.25	\$43.50

The result of smoothing out the rate increases from year to year is represented below. Also depicted below is a breakdown of charges. Below is an explanation of the rates:

1. The administrative and operation and maintenance charges are a direct allocation to expenses by the Utility.
2. The debt service charges go into effect only when there is long term debt outstanding. Lease purchases, traditionally are paid by administrative & operations and maintenance funding.
3. The depreciation rate is a fluctuating variable in the rate calculation because depreciation can easily be varied and compensated for in future years.

Calculated Rates	ESTIMATED	PROJECTED					
	FY 2013	FY 2014 <sup>1</sup>	FY 2015 <sup>2</sup>	FY 2016	FY 2017	FY 2018	FY 2019
<b>BASED ON SMOOTHING RATE</b>							
Adjusted Monthly Rate	\$16.75	\$26.25	\$29.58	\$33.34	\$37.57	\$42.34	\$47.72
Proposed Monthly Rate	\$16.75	\$26.25	\$29.50	\$33.50	\$37.50	\$42.50	\$47.75
Dollar increase		\$9.50	\$3.25	\$4.00	\$4.00	\$5.00	\$5.25

Proposed Smoothing Rates	ESTIMATED	PROJECTED					
	FY 2013	FY 2014 <sup>1</sup>	FY 2015 <sup>2</sup>	FY 2016	FY 2017	FY 2018	FY 2019
Administrative Rate	\$3.75	\$6.60	\$6.85	\$7.15	\$7.15	\$7.70	\$8.10
Depreciation Rate (per 1,000)	0.35	5.95	\$3.15	\$6.30	\$2.58	\$6.00	\$7.91
O&M Rate (per 1,000)	12.65	13.70	\$14.55	\$15.15	\$15.15	\$16.30	\$19.37
DS Rate	0.00	0.00	\$4.95	\$4.90	\$12.62	\$12.50	\$12.37
Total Monthly Residential Rate	\$16.75	\$26.25	\$29.50	\$33.50	\$37.50	\$42.50	\$47.75

As a reminder, the operational portion of the overall rate is a base charge using 5,000 as a minimum. Commercial and industrial customers are additionally charged \$2.74 per 1,000 gallons above that amount of water usage.

## RATE COMPARISONS

The following table compares Cottonwood’s monthly proposed water and wastewater rates to thirteen other cities, towns and unincorporated areas throughout central and northern Arizona. For consistency with other rate studies, 5,000 gallons of water and 5,000 gallons of wastewater was used to make the comparison table.

Different from previous reports, more current information was used by pulling current rate sheets and contacting the various communities in the rate survey. It should be noted that this is a snapshot of the rates as of May 22, 2013 and several communities are already considering raising rates in the near future.

As with earlier studies, the numbers presented do not include sales tax, other charges beyond based minimums fees, volume charges, or any resulting resource fees similar to those collected by the City of Cottonwood. Also important to note is that some of the rates are for privately owned water and wastewater companies and districts.

Community	Notes	2010 Census Population	5,000 gallons of water		5,000 gallons wastewater		Combined Charges	
			Inside	Outside	Inside	Outside	Inside	Outside
<b>Cottonwood</b>		<b>11,265</b>	<b>\$40.34</b>	<b>\$50.83</b>	<b>\$26.00</b>	<b>\$26.00</b>	<b>\$66.34</b>	<b>\$76.83</b>
Camp Verde	1	10,873	\$40.50	40.50	35.00	35.00	75.50	75.50
Chino Valley		10,817	\$25.29	25.29	53.37	53.37	78.66	78.66
Clarkdale		4,097	\$49.08	49.08	38.00	38.00	87.08	87.08
Flagstaff		65,870	\$29.60	32.56	18.45	20.30	48.05	52.86
Payson	4	15,301	\$37.88	37.88	20.00	20.00	57.88	57.88
Prescott		39,843	\$31.98	44.43	39.72	39.72	71.70	84.15
Prescott Valley	5	38,822	\$24.10	24.10	27.77	27.77	51.87	51.87
Sedona	2	10,031	\$34.32	34.32	47.34	47.34	81.66	81.66
Show Low		10,660	\$27.39	34.05	27.58	27.58	54.97	61.63
Verde Santa Fe	3		\$40.34	50.83	40.14	40.14	80.48	90.97
Wickenburg		6,363	\$11.04	22.08	20.99	20.99	32.03	43.07
Williams		3,023	\$32.25	32.25	34.00	34.00	66.25	66.25
Winslow		9,655	\$22.99	45.06	29.51	59.02	52.50	104.08
<b>Average</b>			\$31.29	36.34	33.22	35.63	64.51	71.97

Source: Communities websites & personal contacts

1 - Water is privately owned - Camp Verde Water System, Inc. & Verde Lakes Water System & Wastewater  
Camp Verde Sanitation District collects property taxes

2 - Water is operated by Arizona Water Company

3 - Wastewater is provided by Verde Santa Fe Wastewater Co.

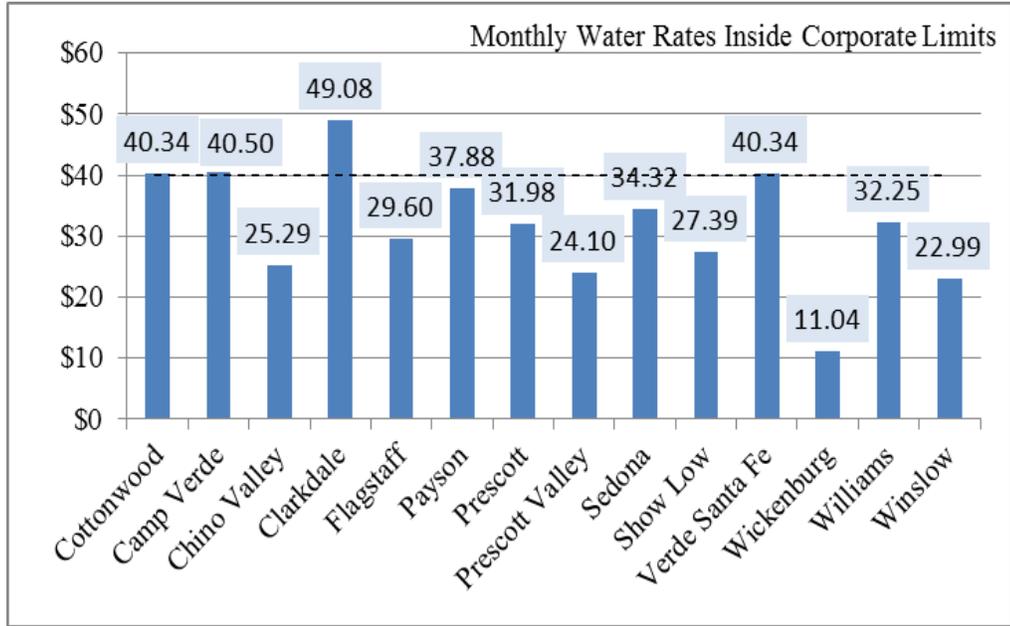
4 - Wastewater is provided by the No. Gila County Sanitary District-collects \$0.60 per \$100 of secondary assessed value

5 - Prescott Valley Sewer not a fixed monthly cost, but based on usage at \$4.54 per 1,000 gallons

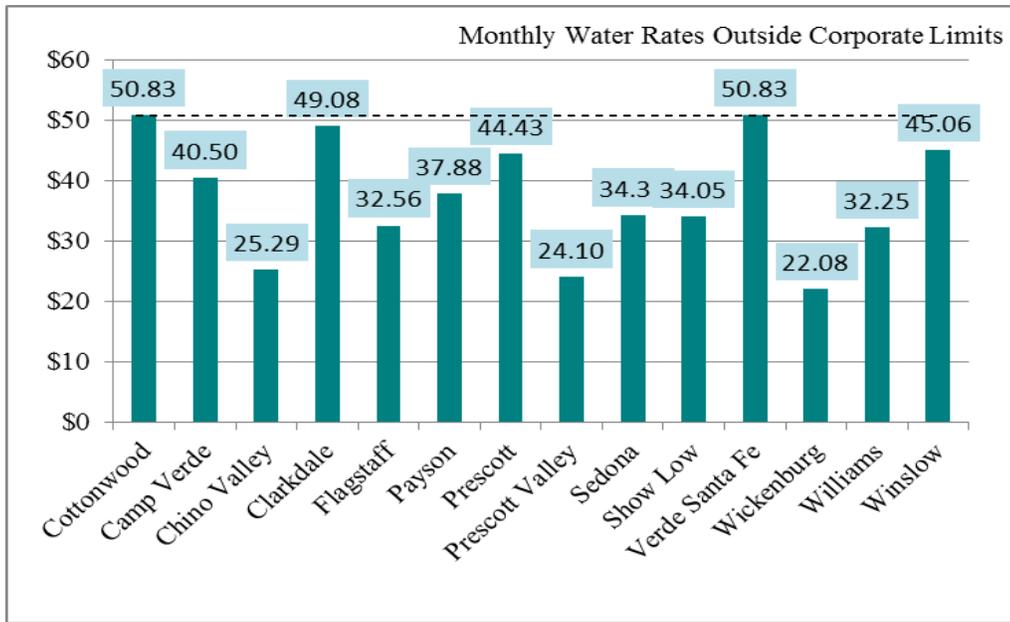
The table clearly depicts this disparity of water rates between inside community corporate limits and outside community corporate limits. In some cases, the rates are doubled. It should be noted that some communities use General Obligation (GO) bonds which are paid through excise taxes, while others, like the City of Cottonwood, use Revenue Bonds which directly impact the rate structure. Traditionally, communities using GO Bonds have lower rates but higher property or other tax rates.

**Water Rates Comparison:**

The proposed rates take into consideration that the cost of services vary between in and out of the corporate City limits for the reasons previously detailed. The following graphs visually depict where Cottonwood in-limit rates will compare to other northern Arizona communities.

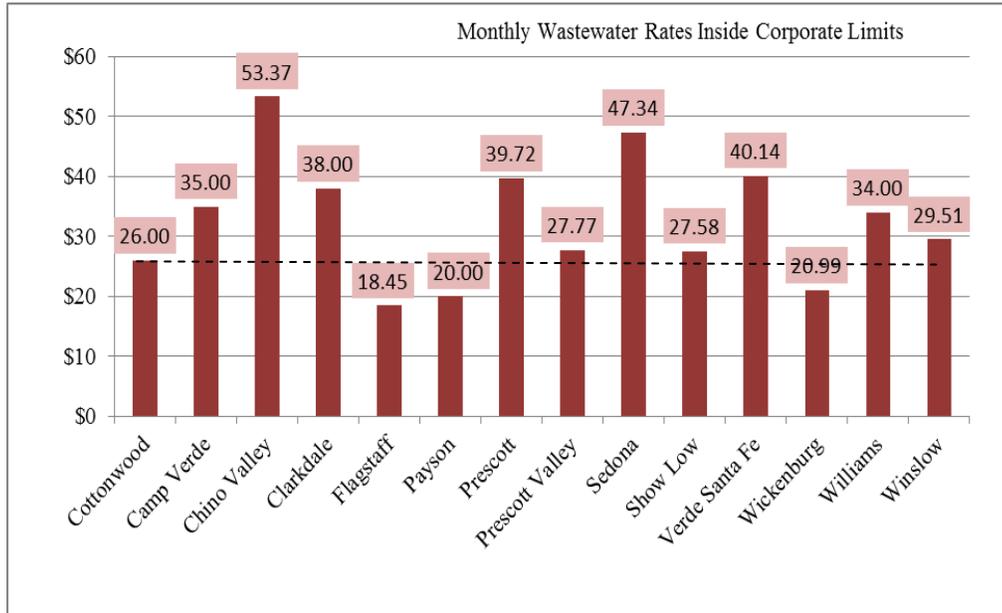


In reality, over 46% of the communities surveyed use higher rates for those water users outside their corporate limits. Some of the communities currently do not provide services outside their boundaries or their coverage is very limited.

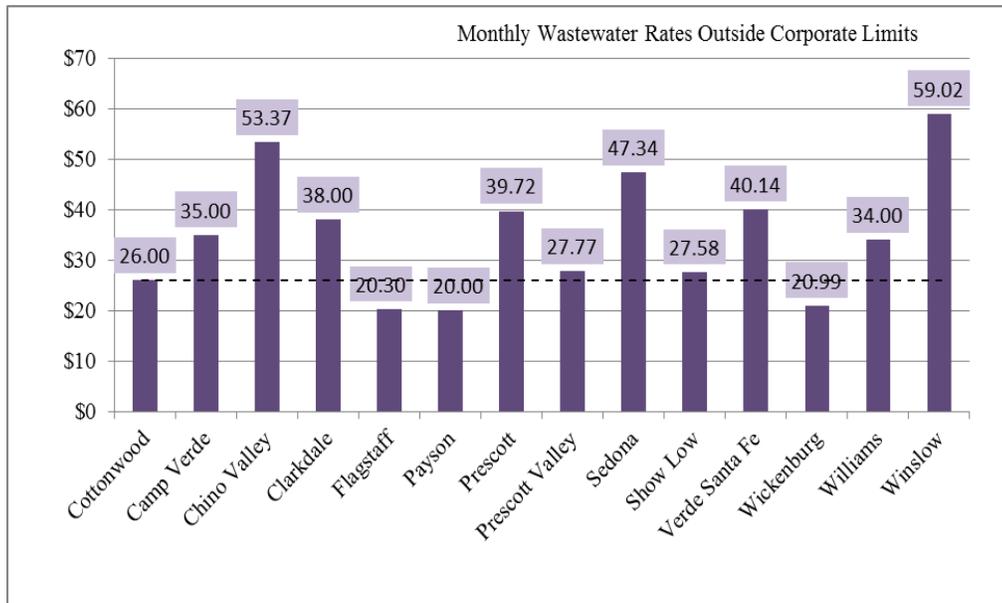


### Wastewater Rates Comparison:

Comparing proposed wastewater rates, the variance among all surveyed is more dramatic. The City of Cottonwood ranks as the fourth lowest out of the field of fourteen. At \$26.00, only Flagstaff, Payson, and Wickenburg are lower at \$18.45, \$20.00 and \$20.99, respectively. Chino Valley is more than double the proposed Cottonwood in-limit rates.

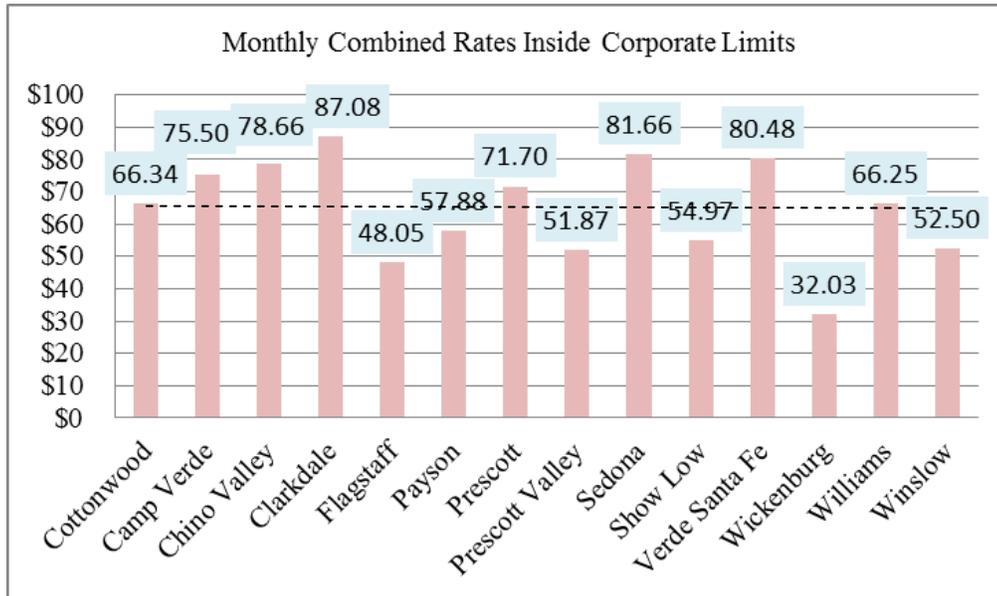


Differential rates in the sample communities are not as prevalent as they are in water rates. Some of these communities do not provide services outside their corporate boundaries.

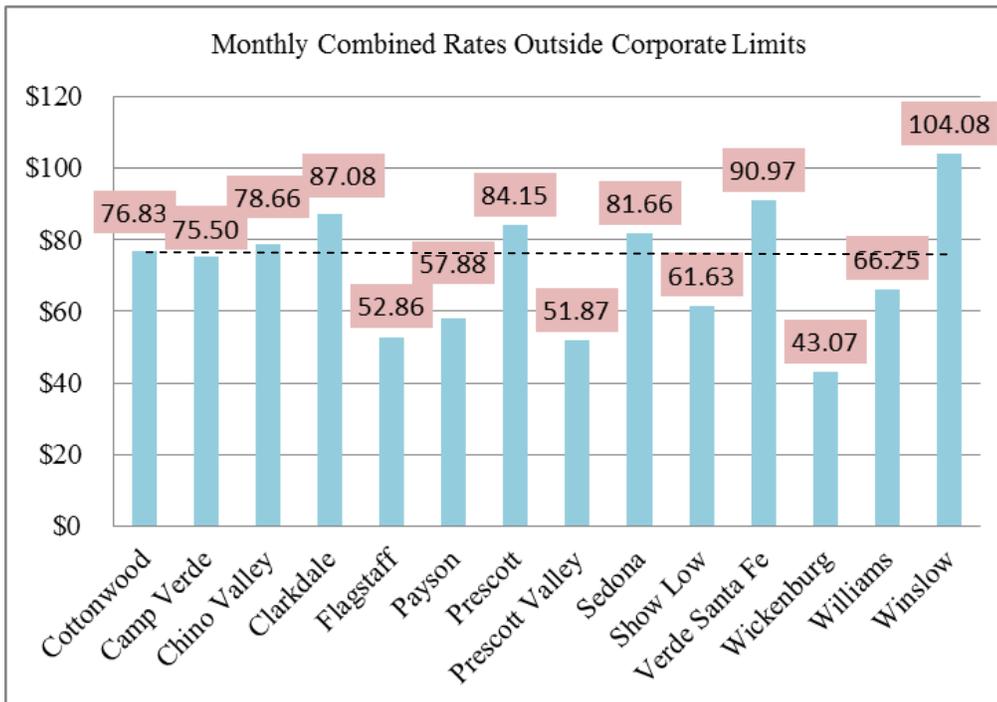


**Combined rates:**

The following table compares combined rates using 5,000 gallons of water and 5,000 gallons of wastewater at residential rates. Inside City limit rates places the City of Cottonwood in the middle of all those surveyed.



A review of the overall combined out of City limit rates, the City of Cottonwood is again in the middle of all those surveyed.



**OTHER RECOMMENDED CHANGES**

Staff is proposing a modest increase in water deposits and fees to assist in cost recovery. These fee and deposit amounts have not been altered since the acquisition of the utilities back in November 2004. It is important to also review the utility deposit and fees as part of a comprehensive rate study.

**Water Meter Charge:**

Water Meter Size (inches)	Current Charge	Proposed New Charge
5/8"	\$275	\$400
1"	\$400	\$475
1 1/2"	\$850	\$970
2"	\$1,150	\$1,250
3"	\$1,700	\$2,000
4"	\$2,500	\$3,000
6"	\$4,850	\$6,000
8"	\$9,400	\$12,000

**Account Fees:**

Deposits:

	Deposit Amount 1		
	Current Fee	Proposed New Fee - Owner	Proposed New Fee - Tenant
5/8"	\$100	\$100	\$125
1"	\$125	\$125	\$150
1 1/2"	\$150	\$150	\$200
2"	\$200	\$200	\$300
3"	\$300	\$300	\$500
4"	\$350	\$350	\$650
6"	\$400	\$400	\$800
8"	\$600	\$600	\$1,000

1 - If an account is turned off for non-pay, there will be an additional \$25.00 deposit charge per occurrence.

**Water Service Establishment Fees**

Current Fee	Proposed New Fee - Inside	Proposed New Fee - Outside
\$25	\$35	\$45

**OTHER RECOMMENDED CHANGES - CONTINUED**

**Emergency and Construction Turn-On/Turn Off**

	Current Charge	Proposed New Charge - Inside	Proposed New Charge - Outside
Regular Business Hours	\$25	\$35	\$45
Non-Business Hours	\$75	\$95	\$105

**Non-metered Fire Sprinkler Line Monthly Standby Fee**

Line Size	Current Fee	Proposed New Fee
4" line	\$20	\$25
6" line	\$35	\$40
8" line	\$50	\$60

**Reconnections (Per Disconnection For Non-Payment)**

	Current Charge	Proposed New Charge - Inside	Proposed New Charge - Outside
	\$25	\$35	\$45

**Meter Re-Reading/Test**

Determined by cost of test and shipping

**Account Delinquencies**

	Current Charge	Proposed New Charge
On 11th day past-due	\$5	\$10
Subsequent past-due (per month)	0.833% mo.	

## **APPENDIX**

**Rating Update: MOODY'S DOWNGRADES COTTONWOOD MUNICIPAL PROPERTY CORPORATION WATER ENTERPRISE (AZ) RATING TO Baa1 FROM A3**

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Global Credit Research - 20 May 2011

**NEGATIVE OUTLOOK REMOVED; Baa1 RATING AFFECTS \$34.6 MILLION OF RATED DEBT OUTSTANDING**

Cottonwood Munic. Prop. Corp., AZ Wtr. Ent.  
Water/Sewer  
AZ

**Opinion**

NEW YORK, May 20, 2011 – Moody's Investors Service has downgraded Cottonwood Municipal Property Corporation Water Enterprise (AZ) senior lien debt obligations to Baa1 from A3 affecting \$34.6 million in outstanding debt. The bonds are secured by the lease purchase payments made by the City from net water utility system revenues.

**SUMMARY RATING RATIONALE**

The Baa1 rating and downgrade reflects the city's weakened financial position, which has contributed to violation of the rate covenant for two consecutive years and a decline in the City's cash margins. The Baa1 rating also reflects the essentiality of the service, stable customer base, weak debt ratio and reluctance to raise rates to generate adequate net revenues for the payment of debt service. The removal of the negative outlook reflects management's commitment to increase coverage levels to comply with the rate covenant through expenditure cuts and rate increases over the next couple years.

**STRENGTHS**

- Ample liquidity position
- Adequate system capacity to meet future demand

**CHALLENGES**

- Multiple year rate increases to restore coverage levels to 1.35x rate covenant
- Above average debt ratio

**DETAILED CREDIT DISCUSSION**

**SYSTEM EXHIBITS TREND OF DECLINING COVERAGE AND LIQUIDITY LEVELS**

The System's debt service coverage levels have declined in recent years as a result of declining operating revenue and expenditure pressures stemming from increased repair and replacement costs. In fiscal 2009 and fiscal 2010 debt service coverage fell to 1.10x and 1.11x respectively, which fell below the rate covenant of 1.35x coverage on a net revenue basis. Despite an 8% rate increase, which was approved by City Council in fiscal 2010, management projects fiscal 2011 coverage to be 1.08x. Management acknowledges the need to increase coverage levels to satisfy the rate covenant and plans to do so through a collection of expenditure cuts and rate increases.

**AMPLE LIQUIDITY DESPITE RECENT DRAWDOWNS**

The System's liquidity position has declined in recent years as a result of increased capital expenditures related to needed repairs to existing water lines and costs related to water quality. Management has indicated that arsenic levels have been reduced and is compliance with water regulation standards. Days Cash on Hand declined from 927 days in fiscal 2009 to 504 days in fiscal 2010. Management has indicated that there is no expectation to utilize cash reserves outside of standard repair and maintenance charges. Moody's believes the on-going maintenance of the system's ample liquidity position remains a significant credit factor. In addition, the City has indicated that the system maintains a fully cash funded debt service reserve account.

**DIVERSIFIED, MATURE SERVICE AREA WITH ADEQUATE CAPACITY TO MEET FUTURE DEMAND**

The City of Cottonwood (UTGO, rated A1) is located 50 miles south of Flagstaff (UTGO rated Aa2) and about 20 miles southwest of the City of Sedona. Recreational tourism and services for retirees are important economic drivers for the region. The system's service area includes the city limits and surrounding areas adjacent to the city limits. The system's capacity includes all above ground storage facilities including 21 reservoirs with a capacity of 3.4 million gallons, which remains sufficient to meet future demand. The system remains diversified with the top ten customers making up 4.19% of the systems total revenues.

**WHAT COULD MAKE THE RATING GO UP**

- \* Demonstrated trend of increasing net revenues and debt service coverage above the rate covenant

**WHAT COULD MAKE THE RATING GO DOWN**

- \* Further deterioration of the system's coverage levels and cash position

**KEY STATISTICS:**

Security: Secured by the lease purchase payments made by the City from net water utility system revenues

Legal Provisions: Slightly stronger than standard with a rate covenant and additional bonds test of 1.35x of annual debt service coverage.

Total Accounts (2009): 9,127

Fiscal 2010 operating ratio: 67%

Fiscal 2010 Debt Service Coverage: 1.11 times

Fiscal 2010 Days Cash on Hand: 504

Debt Ratio: 116.6%

Projected Payout (10 years): 32%

The principal methodology used in this rating was *Analytical Framework For Water And Sewer System Ratings* published in August 1999.

#### REGULATORY DISCLOSURES

Information sources used to prepare the credit rating are the following: parties involved in the ratings and public information.

Moody's Investors Service considers the quality of information available on the credit satisfactory for the purposes of maintaining a credit rating.

Moody's adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources Moody's considers to be reliable including, when appropriate, independent third-party sources. However, Moody's is not an auditor and cannot in every instance independently verify or validate information received in the rating process.

Please see ratings tab on the issuer/entity page on [Moody's.com](http://Moody's.com) for the last rating action and the rating history.

The date on which some Credit Ratings were first released goes back to a time before Moody's Investors Service's Credit Ratings were fully digitized and accurate data may not be available. Consequently, Moody's Investors Service provides a date that it believes is the most reliable and accurate based on the information that is available to it. Please see the ratings disclosure page on our website [www.moody's.com](http://www.moody's.com) for further information.

Please see the Credit Policy page on [Moody's.com](http://Moody's.com) for the methodologies used in determining ratings, further information on the meaning of each rating category and the definition of default and recovery.

#### Analysts

Drew Henriques  
Analyst  
Public Finance Group  
Moody's Investors Service

Orlie Prince  
Backup Analyst  
Public Finance Group  
Moody's Investors Service

#### Contacts

Journalists: (212) 553-0376  
Research Clients: (212) 553-1653

Moody's Investors Service  
250 Greenwich Street  
New York, NY 10007  
USA



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# RatingsDirect®

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## Summary:

# Cottonwood Municipal Property Corp. Cottonwood, Arizona; Water/Sewer

### Primary Credit Analyst:

Corey A Friedman, Chicago (1) 312-233-7010; corey.friedman@standardandpoors.com

### Secondary Contact:

Robert L Hannay, CFA, San Francisco (1) 415-371-5038; robert.hannay@standardandpoors.com

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Rationale

Outlook

Related Criteria And Research

## Summary:

# Cottonwood Municipal Property Corp. Cottonwood, Arizona; Water/Sewer

### Credit Profile

**Cottonwood Mun Prop Corp, Arizona**

Cottonwood, Arizona

**Cottonwood Mun Prop Corp sr lien wtr sys**

*Unenhanced Rating*

BBB+(SPUR)/Negative

Downgraded

Many issues are enhanced by bond insurance.

## Rationale

Standard & Poor's Ratings Services has lowered its long-term rating on Cottonwood Municipal Property Corp., Ariz.'s water revenue bonds, series 2004 and 2006, to 'BBB+' from 'A', reflecting the city's recent trend of insufficient annual debt service coverage from net revenues while relying on cash reserves to make sufficient coverage. The outlook is negative.

The rating and outlook reflect our opinion of the water system's:

- Inability to meet debt service requirements using net available revenues, which has led to the system using cash reserves to sufficiently cover debt service payments;
- Infrequent rate increases to sufficiently support annual debt service payments and future rate increases, which, while projected, have not been approved;
- Extremely high debt to plant ratios, with the city potentially adding additional debt to support its moderate capital plan; and
- Affordable rates in comparison to the city's underlying economic characteristics.

We view the bond provisions as adequate. The bonds are secured by the net revenues of the water system. Covenants include a 1.35x rate covenant and a 1.35x maximum annual debt service additional bonds test. Impact fees are considered part of the revenues for satisfying the rate covenant, but the system has been insufficient even in recent years to meet the coverage requirements.

In our view, the system's financial performance has been weakened due to rates being insufficient to cover operating expenditures and consequently not satisfying the system's rate covenant on the bonds. Based on audited results, we calculate debt service coverage (DSC) for fiscal 2012 at 0.96x, which we consider insufficient based on the system's rate covenant of 1.35x; this follows weak DSC at 0.87x and 1.16x for fiscal years 2010 and 2011, respectively. Based on the city's fiscal 2013 budget, we estimate that fiscal 2013 DSC will be about 0.98x. The city believes it will be more than 1x annual debt service when including impact fees. Additionally, when the city was below its rate covenant, it had to use reserves to cover some of the debt service as well as to address its capital needs. According to management, pending approval of the city's proposed rates, it is expecting to reach 1.35x coverage in fiscal 2014 and stay between

1.35x and 1.40x for the next five years. To reach this goal, according to management, the city will have to make one substantial increase in fiscal 2014 and then make smaller annual increases to maintain coverage. However, given that rates have been raised infrequently, with the last one in 2010, we believe this creates additional pressure to maintain even sufficiency coverage. Although the city has been in violation of the system's 2004 and 2006 revenue bond covenants, no action has been taken to make the city meet its coverage requirements.

Liquidity has ranged between good and strong during the past four fiscal years and we anticipate that it will remain good. Cash on hand at the end of fiscal 2012 totaled \$7 million. Of this total, the city considers only \$2 million to be unrestricted, which translates to 201 days' unrestricted cash and investments, which we consider good. The remainder is earmarked for water resource development. Based on the city's audited financial statements, liquidity during the past four fiscal years was no lower than 113 days. As of May 30, 2013, unrestricted cash and investments totaled \$5.1 million out of which \$1.56 million is available. Management's goal is to maintain at least 60 days of operating expenditures. Cash has fluctuated in recent years, with levels at more than \$2.3 million in fiscal 2011 (273 days) but just over \$1 million (113 days) in fiscal 2010.

Cottonwood Municipal Property Corp. is part of Yavapai County in central Arizona, 50 miles south of Flagstaff, and borders the Verde River to its north. Cottonwood City's population increased during the past five years from 2008 to 2012 by 7.6% to 11,827. Management reports that it expects moderate growth in the area over the next five years. Yavapai County's unemployment rates were moderately high during the past three years, ranging from 7.9%-11.4% and most recently stood at 8.1% in April 2013. We consider Cottonwood and Yavapai County's income levels to be adequate based on the median household effective buying income (EBI) at 76% and 86% of the national level in 2012, respectively.

The city serves a stable, primarily residential, and very diverse customer base. During the past five fiscal years, water accounts decreased by 0.4% to 9,000 accounts in fiscal year 2012 from 9,040 accounts in fiscal year 2008. We consider the customer base to be primarily residential, with residential customers accounting for about 93% of water meters. The district's customer base is also very diverse, in our opinion, as the 10 leading customers pay about 0.78% of water service charges and the leading customer, Verde Valley Medical Center, pays 0.33% of water service charges annually.

The system provides water treatment, storage, and delivery services to some households and businesses within and adjacent to the city and includes some limited outlying areas of Yavapai County. In 2004, the city entered into the water utility business after acquiring three private water companies. Its only source of supply is groundwater, which is pumped through wells. In fiscal 2012, the average daily demand was 2.1 million gallons per day (mgd) with a peak day demand of 2.7 mgd. According to city management, Cottonwood has ample water supply.

Water rates are moderate but are anticipated to increase in the future, assuming city council approval. Customers pay their water service charges along with their sewer charges monthly. The water charge is \$39.53 per 8,000 gallons for fiscal year 2013. The city last raised rates by 8% in 2010, but continues to review them annually. Total water and sewer bills total \$53.26, which translates to an affordable 2.2% of underlying median household EBI. As of fiscal 2014, monthly water rates are proposed to increase by 16% to \$50.32. Water rates are projected to increase by 2% from fiscal years 2015 through 2019. According to management, the city is still discussing future water rates and will be proposing these plans to council in June and implementing them Oct. 1, 2013 at the earliest. Management is also

planning on scheduling its rate committee to meet regularly on rate issues as well as report to council over the year. The city currently has 3,250 closed accounts that total \$358,610 in delinquencies, which management doesn't believe it will collect. Once a bill is past due, the water is turned off unless the total past due bill is paid.

Cottonwood's capital improvement plan for the next five years is, in our view, moderate but could add to an already highly leveraged debt position at 175% debt to plant with \$33 million of bonds outstanding in fiscal 2012. The city could also seek additional funding for continued improvements to the water system and has plans to refinance through the state's Water Infrastructure Finance Authority. These two actions are dependent on future water rate increases and the city maintaining its rate covenant. In aggregate, over the next five years management anticipates capital project spending about \$8 million, of which \$5 million would be new debt issuance.

## Outlook

The negative outlook reflects our view of the city's historical inability to meet debt service requirements from net available revenues and our opinion that this trend could continue if the city does not make timely budget adjustments to meet at least sufficient coverage. If the city still fails to take the necessary budgetary action, whether through the more likely appropriate revenue enhancements or expenditure reductions, to meet its coverage requirements, we could lower the rating during the current two-year outlook. Meeting at least sufficient coverage from net available revenues could lead us to revise the outlook to stable at the current rating level. Upward rating movement is limited during the current outlook period.

## Related Criteria And Research

- USPF Criteria: Standard & Poor's Revises Criteria For Rating Water, Sewer, And Drainage Utility Revenue Bonds, Sept. 15, 2008
- USPF Criteria: Key Water And Sewer Utility Credit Ratio Ranges, Sept. 15, 2008

Complete ratings information is available to subscribers of RatingsDirect at [www.globalcreditportal.com](http://www.globalcreditportal.com). All ratings affected by this rating action can be found on Standard & Poor's public Web site at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

Syncora Guarantee Inc.  
135 West 50<sup>th</sup> Street  
20<sup>th</sup> Floor  
New York, NY 10020  
+1 212 478 3400 Phone  
+1 212 478 3587 Fax  
www.syncora.com



June 7, 2013

The Bank of New York Trust Company, N.A.  
700 South Flower Street, Suite 500  
Los Angeles, CA 90017-4104  
Attention: Corporate Trust Services

cc: Jesus "Rudy" Rodriguez  
Administrative Services General Manager  
City of Cottonwood  
816 North Main Street  
Cottonwood, Arizona 86326

Re: Notice of Noncompliance with Series 2004 and Series 2006 City Purchase Agreements between City of Cottonwood, Arizona and City of Cottonwood Municipal Property Corporation

Ladies and Gentlemen:

Reference is made to the Bond Indenture dated as of October 1, 2004 (the "2004 Indenture"), between City of Cottonwood Municipal Property Corporation (the "Corporation") and BNY Western Trust Company ("BNY Western"), as trustee, securing the City of Cottonwood Municipal Property Corporation Senior Lien Water System Revenue Bonds, Series 2004 (the "2004 Bonds") and the Obligation Indenture dated as of January 1, 2006 (the "2006 Indenture" and together with the 2004 Indenture, the "Indentures"), among the City of Cottonwood, Arizona (the "City"), the Corporation and The Bank of New York Trust Company, N.A. ("BONY" and together with BNY Western, "BNY"), as obligation trustee, securing the Senior Lien Water System Revenue Obligations, Series 2006 (the "2006 Obligations" and together with the 2004 Bonds, the "Bonds"). Syncora Guarantee Inc. f/k/a XL Capital Assurance Inc. ("Syncora") is the bond insurer on the Bonds. Further reference is made to the City Purchase Agreement dated as of October 1, 2004 (the "Series 2004 Purchase Agreement"), between the City, as purchaser, and the Corporation, as seller, and the Series 2006 City Purchase Agreement dated as of January 1, 2006 (the "Series 2006 Purchase Agreement" and together with the Series 2004 Purchase Agreement, the "Purchase Agreements"), between the City, as purchaser, and the Corporation, as seller. Defined terms used but not defined herein shall have the meanings ascribed to them in the related Indenture or the related Purchase Agreement, as appropriate.

Section 4.2(b) of the Series 2004 Purchase Agreement contains a rate covenant (the "Series 2004 Rate Covenant") which provides, in part, that the City shall fix fees "to produce Net Revenues in each Fiscal Year which will equal at least 135% of the interest and Principal Requirement for the then current Bond Year on all Senior Lien Obligations then outstanding". Section 4.2(b) of the Series 2006 Purchase Agreement contains a rate covenant (the "Series 2006 Rate Covenant" and together with the Series 2004 Rate Covenant, the "Rate Covenants") which provides, in part, that the City shall fix fees "to produce Net Revenues (excluding, however, from a calculation thereof for this purpose only the amounts received by the City pursuant to the Intergovernmental Utilities Purchase Agreement) in each Fiscal Year which will equal at least 135% of the interest and Principal Requirement (excluding, however, from the calculation thereof for this purpose only the portion of such interest and Principal Requirement allocable to each

Clarkdale Maturity Amount) for the then current Bond Year on all Senior Lien Obligations then outstanding.” The City is not currently and has not been compliant with the Rate Covenants for more than three years (as shown on the attached exhibit from the City’s 2012 financial statement). Section 7.1(c) of each Purchase Agreement provides that an Event of Default occurs when “the City shall fail to perform any other covenant herein for a period of thirty (30) days after written notice specifying such default shall have been given to the City by the Corporation or the Trustee...”.

Section 12.3 of each Indenture provides that “[Syncora] shall be recognized as the registered Holder of each Bond which it insures for the purposes of exercising all rights and privileges available to the Holders.”

Pursuant to Section 6.4 of each Indenture provides that BNY may enforce all rights of the Corporation and all obligations of the City under the Purchase Agreements.

By this letter, Syncora hereby requests that BNY promptly deliver a notice to the City of its noncompliance with Section 4.2(b) of each Purchase Agreement and a demand to correct such noncompliance as soon as practicable.

Please be advised that Syncora reserves all of its rights and remedies in connection with the City’s noncompliance under the Purchase Agreement (including, without limitation, the right to exercise such rights and remedies without further notice), and that no failure or delay by Syncora in exercising any such right or remedy shall operate as a waiver thereof.

Please do not hesitate to contact Mary Rose Kaddo at (212) 478-3620 if you have any questions with respect to this letter.

Very truly yours,

SYNCORA GUARANTEE INC

By:

Name:

Title:

  
Charles E. Reilly  
Managing Director



BNY MELLON

June 25, 2013

City of Cottonwood, Arizona  
Attn: Jesus Rudy Rodriguez, Administrative Services General Manager  
816 North Main Street  
Cottonwood, AZ 86326  
(Via Email: [rodriguez@cottonwoodaz.gov](mailto:rodriguez@cottonwoodaz.gov))

**Re: Notice of Noncompliance with Series 2004 and Series 2006 City Purchase Agreements  
Between City of Cottonwood, Arizona and City of Cottonwood Municipal Property  
Corporation**

Dear Sirs:

Reference is made to the Bond Indenture dated as of October 1, 2004 (the "2004 Indenture"), between City of Cottonwood Municipal Property Corporation (the "Corporation") and The Bank of New York Mellon Trust Company, N.A., successor-in-interest to BNY Western Trust Company, as trustee (the "Bond Trustee"), securing the City of Cottonwood Municipal Property Corporation Senior Lien Water System Revenue Bonds, Series 2004 (the "2004 Bonds") and the Obligation Indenture dated as of January 1, 2006 (the "2006 Indenture" and together with the 2004 Indenture, the "Indentures"), among the City of Cottonwood, Arizona, (the "City"), the Corporation and The Bank of New York Mellon Trust Company, N.A., formerly known as The Bank of New York Trust Company, N.A. as obligation trustee (the "Obligation Trustee" and together with the Bond Trustee, the "Trustee"), securing the Senior Lien Water System Revenue Obligations, Series 2006 (the "2006 Obligations" and together with the 2004 Bonds, the "Bonds"). Further reference is made to the City Purchase Agreement dated as of October 1, 2004 (the "Series 2004 Purchase Agreement"), between the City, as purchaser, and the Corporation, as seller, and the Series 2006 City Purchase Agreement dated as of January 1, 2006 (the "Series 2006 Purchase Agreement" and together with the Series 2004 Purchase Agreement, the "Purchase Agreements"), between the City, as purchaser, and the Corporation, as seller. Defined terms used but not defined herein shall have the meanings ascribed to them in the related Indenture or the related Purchase Agreement, as appropriate.

Section 4.2(b) of the Series 2004 Purchase Agreement contains a rate covenant (the "Series 2004 Rate Covenant") which provides, in part, that the City shall fix fees "to produce Net Revenues in each Fiscal Year which will equal at least 135% of the interest and Principal Requirement for the then current Bond Year on all Senior Lien Obligations then outstanding". Section 4.2(b) of the Series 2006 Purchase Agreement contains a rate covenant (the "Series 2006 Rate Covenant" and together with the Series 2004 Rate Covenant, the "Rate Covenants") which provides, in part, that the City shall fix fees "to produce Net Revenues (excluding, however, from a calculation thereof for this purpose only the amounts received by the City pursuant to the Intergovernmental Utilities Purchase Agreement) in each Fiscal Year which will equal to at least 135% of the interest and Principal Requirement (excluding, however, from the calculation thereof for this purpose only the portion of such interest and Principal Requirement allocable to each Clarkdale Maturity Amount) for the then current Bond Year on all Senior Obligations then outstanding". The City is not currently and has not been compliant with the Rate Covenants for more than three years (as shown in the City's 2012 financial statement).

The Bank of New York Mellon Trust Company, N.A., 601 Travis Houston, Texas 77002

Section 7.1(c) of each Purchase Agreement provides that an Event of Default occurs when “the City shall fail to perform any other covenant herein for a period of thirty (30) days after written notice specifying such default shall have been given to the City by the Corporation or the Trustee, provided that if such failure be such that it cannot be remedied within such 30 day period, it shall not be deemed an Event of Default so long as the City diligently tries to remedy the same”.

**The Trustee hereby notifies the City of the noncompliance with Section 4.2(b) of each Purchase Agreement, and that such noncompliance could become an Event of Default under Section 7.1(c) of each Purchase Agreement and under Section 7.1(e) of each Indenture. The Trustee hereby demands the City to immediately remedy the potential Events of Default, pursuant to the requirements of the Purchase Agreements and the Indentures.**

**The Trustee also calls your attention to Section 4.2(d) of the Series 2004 Purchase Agreement which states “If the City fails to comply with the foregoing covenant in any Fiscal Year while the Policy is in effect and the Bond Insurer is not in default there under, the City shall cause a rate study in substantially the form of the ‘Water Rates Study and Long Term Financial Plan’ prepared in connection with the issuance of the Bonds to be prepared within 180 days of the end of such Fiscal Year and shall provide a copy of the same to the Bond Insurer”.**

The failure to list other failures, defaults or Events of Defaults that may currently exist or may arise hereafter does not constitute, and shall not be deemed a waiver of any such failures, defaults or Events of Default by the Trustee. The Trustee hereby reserves all of its rights, including the right to take whatever remedial actions it deems necessary at any time after the occurrence and during the continuation of an of an Event of Default. The failure to take immediate action does not constitute and shall not be deemed a waiver of the Trustee’s rights or remedies.

Please advise the Trustee of remedial steps the City is considering. If you have questions concerning this Notice, please contact the Trustee, Attn: J. Chris Matthews, 601 Travis, 16<sup>th</sup> Floor, Houston, Texas 77002, via phone at (713) - 483-6267 or email to [j.chris.matthews@bnymellon.com](mailto:j.chris.matthews@bnymellon.com).

Sincerely,



J. Chris Matthews  
Vice President

cc:

City of Cottonwood Municipal Property Corporation  
Attn: President  
c/o City of Cottonwood, Arizona  
827 North Main Street  
Cottonwood, Arizona 86326

Syncora Guarantee Inc.  
Attn: Mary Rose Kaddo  
135 West 50 Street  
New York, N.Y. 10020

City of Cottonwood, Arizona.  
Attn: City Manager  
827 North Main Street  
Cottonwood, Arizona 86326