

Karegnondi Water Authority

**Financial Report
September 30, 2016**

Karegnondi Water Authority

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Independent Auditor's Report

To the Board of Directors
Karegnondi Water Authority

Report on the Financial Statements

We have audited the accompanying basic financial statements of Karegnondi Water Authority (the "Authority"), a component unit of Genesee County Water and Waste Services, as of and for the years ended September 30, 2016 and 2015, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits 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 auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

To the Board of Directors
Karegnondi Water Authority

Opinion

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of Karegnondi Water Authority as of September 30, 2016 and 2015 and the changes in its financial position and its cash flows thereof for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

Other Matter

Required Supplemental Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, as identified in the table of contents, 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, which 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 supplemental 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.

Plante & Moran, PLLC

February 6, 2017

Karegnondi Water Authority

Management's Discussion and Analysis

Karegnondi Water Authority (KWA or the "Authority") was incorporated in October 2010 pursuant to Act 233, Public Acts of Michigan, 1955, as amended, by the County of Genesee (Genesee Co.), the County of Lapeer, the County of Sanilac, the City of Flint (Flint), and the City of Lapeer for the purpose of providing its member communities with a new source of water for treatment and distribution. This new water source will come from a Water Supply System (the "System") which has been recently completed. The System will deliver Lake Huron water to its customers.

The System is expected ultimately to supply raw water to a three-county area consisting of over 2,200 square miles and a population of over one half million residents. The System will initially provide raw water to the communities in Flint and Genesee Co. Currently, Flint and Genesee Co. receive finished water from the Great Lakes Water Authority (GLWA).

The KWA will supply metered, untreated water to contracting members who will, in turn, be responsible for treating and distributing treated water to their individual customers. The actual cost for administration, operation, and maintenance of the System will be allocated based on water sold, and each contracting member will be responsible for its proportional share of these costs.

The KWA currently has entered into two Water Purchase Contracts (the "Contract(s)") effective October 1, 2013, one with Flint to supply up to 18 million gallons per day (mgd), and one with the Genesee County Drain Commissioner, as County Agency of Genesee Co. under Act 342, Public Acts of Michigan, 1939, as amended (the "County Agency"), on behalf of Genesee Co., to supply up to 42 mgd. The charges to be paid by Flint and the County Agency in the Contracts are broken down into two distinct portions: an annual fixed or debt recovery fee and an annual commodity or operations and maintenance fee. Flint and the County Agency expect to pay such charges from the revenue of their respective water supply systems as an operation and maintenance expense in the same manner that each paid or presently pays for water furnished by GLWA.

The KWA established the size of the System which is based on the volumes identified in the Contracts. Each contracting party is responsible for the annual fixed fee regardless of the amount of water taken, which equates to its share of the debt service.

The System

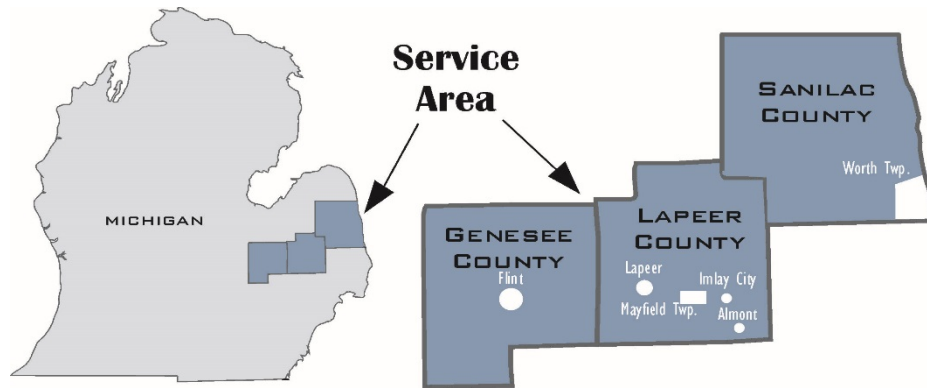
To supply water to its contracting members, the KWA constructed two lake intakes in Lake Huron, approximately 63 miles of pipe from the intake to the City of Flint, and three pump stations. These facilities collectively constitute the System. The engineering design of the System was to withdraw water from Lake Huron and pump it to a standpipe in Lynn Township in St. Clair County, and from there, re-pump the water to a site in Oregon Township in Lapeer County, approximately 14 miles east of Flint. That site features a 125 million gallon reservoir (also known as an impoundment) which was completed in 2016, along with the County Agency's new water treatment plant which is scheduled for completion in mid-2017.

Karegnondi Water Authority

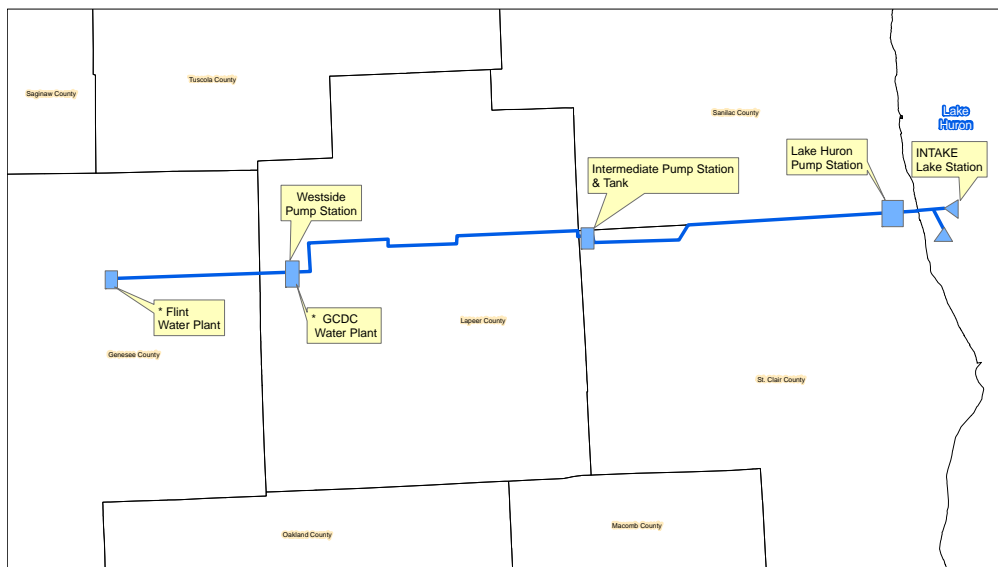
Management's Discussion and Analysis (Continued)

The impoundment and new treatment plant will be owned and operated by the County Agency. A third pump station will continue to pump untreated water from the County Agency's site to Flint's water treatment plant. Figure I shows the location of the System facilities, the Flint water treatment plant, and the County Agency treatment plant and impoundment.

Figure I



The intake facility and property were financed through the issuance of bonds by the Genesee Co. Agency in the principal amount of \$35,000,000 in October 2013, with the understanding that the County Agency would make the Intake and property available to the KWA for use by the KWA as part of the System. Genesee Co. is solely responsible for paying the principal of and interest on these bonds from the net revenue derived from its users. Genesee Co. has pledged its limited tax full faith and credit as additional security for the bonds. The lake intake construction and testing was completed in 2016. The County Agency has entered into an agreement which calls for the ownership of the Intake to be transferred to the KWA once the intake debt has been retired.



Karegnondi Water Authority

Management's Discussion and Analysis (Continued)

The KWA retained the services of the County Agency to administer the design and construction of the System. The County Agency provided these services at no cost to the KWA since its inception through September 2014. In October 2014, the KWA began paying the County Agency \$3,000.00 monthly for these services. In addition, it is expected that the KWA will also contract with the County Agency for operation and maintenance of the System after the System is completed and fully operational. The County Agency has significant experience in planning, operating, and managing water and wastewater systems, having been responsible for planning, operating, and managing its own system since 1966. The County Agency currently employs approximately 132 people in connection with the operation and management of its current system, and it is expected that from this group, five full-time equivalent employees will be involved in the operation and maintenance of the System. The KWA is not expected to have any employees.

On behalf of the KWA, the County Agency acquired 40 acres of land with 100 feet of frontage on Lake Huron in Sanilac County for the intake plant and first pump station, and 40 acres of land on the northwest corner of Martin Road and Hull Road in Lynn Township in St. Clair County for the standpipe (ground storage tank) and second pump station. The County Agency also acquired approximately 80 acres of land on the northeast corner of Marathon Road and Stanley Road in Oregon Township in Lapeer County to serve as the site for the County Agency's new water treatment plant, reservoir, and the KWA's Westside Pump Station.

Prior to construction of the System, the County Agency obtained a permit from the Michigan Department of Environmental Quality (MDEQ) authorizing the withdrawal of up to 85 million gallons per day (mgd) from Lake Huron. The design and construction were broken up into eight individual projects as follows:

- Lake Huron Pump Station
- 12 miles of 66-inch transmission main
- 12 miles of 66-inch transmission main
- Intermediate Pump Station and Standpipe
- 12 miles of 60-inch transmission main
- 13 miles of 60-inch transmission main
- Westside Pump Station
- 14 miles of 36-inch transmission main

The final construction costs for the System, including the lake intake and site financed by the County Agency, are expected to be under \$293,000,000 based on water purchase contracts of 60 mgd.

Karegnondi Water Authority

Management's Discussion and Analysis (Continued)

Interim Water Supply Arrangements for Genesee Co. and Flint

Flint had purchased treated water from GLWA for approximately 40 years, during which time the County Agency had a contract with Flint that required Flint to purchase water from GLWA and provide that water to the County Agency. At this time, both Flint and the County Agency are purchasing treated water directly from GLWA. Flint has a contract through June 2017, while the County Agency is purchasing water without a contract.

Related Facilities

In order to provide finished water to its customers, Flint is currently making or planning to make upgrades to its existing water treatment plant. In order to provide finished water to Genesee County customers, the County Agency is building a new water treatment plant, reservoir, and approximately five miles of water main running from the new treatment plant to the County Agency's main distribution facility at Henderson Road, at an estimated cost of \$120,000,000.

Flint expects to begin purchasing and treating water from the KWA after making the necessary upgrades and receiving the required regulatory approvals. Once the County Agency completes its water treatment plant and associated pipeline in 2017, it will discontinue purchasing water from GLWA and will also begin purchasing and treating water from the KWA. The County Agency's water treatment plant construction is ahead of schedule and expected to be completed in May 2017. The water plant startup and test period are expected to take three to five months.

Objectives

The main objectives of the KWA are to build and maintain a high-quality water delivery system at rates which will be fair and cost-effective to all concerned. And in accordance with its bylaws, the KWA maintains a yearly budget of income and expenses. The budget is reviewed and approved by the KWA board.

Using this Annual Report

This annual report consists of a series of financial statements. The statement of net position, the statement of revenue, expenses, and changes in net position, and the statement of cash flows provide information about the activities of the KWA as a whole and assist in presenting a longer-term view of its finances.

Karegnondi Water Authority

Management's Discussion and Analysis (Continued)

Condensed Financial Information

The following tables present condensed information about the Authority's financial position compared to the prior year:

	September 30		Increase (Decrease)	Percent Change
	2016	2015		
Assets				
Current assets	\$ 7,267,552	\$ 5,603,627	\$ 1,663,925	23%
Restricted assets	45,429,465	108,590,629	(63,161,164)	-139%
Capital assets	<u>310,377,287</u>	<u>181,395,807</u>	<u>128,981,480</u>	42%
Total assets	363,074,304	295,590,063	67,484,241	19%
Liabilities				
Current liabilities	18,575	10,031	8,544	46%
Liabilities payable from restricted assets	14,625,868	21,954,798	(7,328,930)	-50%
Other noncurrent liabilities	5,118,032	3,428,607	1,689,425	33%
Long-term debt	<u>338,451,490</u>	<u>266,527,841</u>	<u>71,923,649</u>	21.3%
Total liabilities	<u>358,213,965</u>	<u>291,921,277</u>	<u>66,292,688</u>	19%
Net Position				
Net investment in capital assets	2,729,394	1,557,297	1,172,097	43%
Unrestricted	<u>2,130,945</u>	<u>2,111,489</u>	<u>19,456</u>	1%
Total net position	<u>\$ 4,860,339</u>	<u>\$ 3,668,786</u>	<u>\$ 1,191,553</u>	25%

Karegnondi Water Authority

Management's Discussion and Analysis (Continued)

	Year Ended September 30		Change	Percent Change
	2016	2015		
Operating Expenses				
Office supplies and insurance	\$ 4,186	\$ 4,792	\$ (606)	-14%
Professional services	190,313	136,192	54,121	28%
Total operating expenses	194,499	140,984	53,515	28%
Operating Loss	(194,499)	(140,984)	(53,515)	28%
Nonoperating Revenue (Expenses)				
Water supply contract operating subsidy	1,938,000	1,938,000	-	0%
Investment income	11,270	4,813	6,457	57%
Bond issuance costs	(563,218)	-	563,218	-100%
Total nonoperating revenue	1,386,052	1,942,813	(556,761)	-40%
Change in Net Position	<u>\$ 1,191,553</u>	<u>\$ 1,801,829</u>	<u>\$ (610,276)</u>	-51%

Major Capital Assets and Debt Activity

The KWA and the local units entered into contracts, whereby the KWA was authorized to issue bonds with a total par value not to exceed \$300,000,000 (collectively, the "System Bonds") to finance the facilities for the System in anticipation of the contractual payments to be made by the local units as provided therein. The contract is contemplated in the Water Purchase Contracts and sets forth the manner in which the capital costs of the System's facilities would be allocated. Under the Contracts, Flint and the County Agency are responsible for paying approximately 34.2 percent and 65.8 percent, respectively, of the debt service on the System Bonds. This allocation takes into account and credits the County Agency for financing and being responsible for the payment of 100 percent of the costs of the intake. In addition, Genesee Co. pledged its limited tax full faith and credit to 100 percent of the debt service on the System Bonds.

Construction began in 2014 with bond construction in progress spending totaling \$244,000,000 through September 30, 2016. Additionally, net bond interest expense of \$31,000,000 and \$35,000,000 related to the capital lease on the intake have been capitalized for a total construction in progress at September 30, 2016 totaling \$310,000,000.

KWA sold \$220,500,000 par value in water system supply bonds in April 2014. Sources and uses of funds were as follows:

Sources of Funds

Par amount of bonds - \$220,500,000.00
Net original issue premium/discount - \$11,815,544.05
Total sources - \$232,315,544.05

Karegnondi Water Authority

Management's Discussion and Analysis (Continued)

Use of Funds

Deposit to construction fund - Initial - \$187,137,367.59
Deposit to construction fund - Subsequent - \$8,606.00
Capitalized interest - \$28,282,364.06
Deposit to debt service reserve account - \$15,237,437.50
Costs of Issuance - \$703,394.00
Underwriters' discount - \$946,374.90
Total uses - \$232,315,544.05

The KWA sold \$74,370,000 par value in water system supply bonds in June 2016.

Sources and uses of funds were as follows:

Sources of Funds

Par amount of bonds - \$74,370,000
Net original issue premium/discount \$0.00
Total sources \$74,370,000.00

Use of Funds

Deposit to construction fund - \$61,999,332.18
Capitalized interest - \$4,878,159.88
Deposit to debt service reserve account - \$6,954,939.94
Costs of issuance - \$223,680.50
Purchaser's fee - \$313,887.50
Total uses - \$74,370,000.00

Financial Review

A discussion of the significant financial activity during the current year is as follows:

Statement of Net Position

- Cash and cash equivalents increased from \$5,396,585 to \$7,159,901 primarily due to planned startup contributions from Flint and the County Agency.
- Capital assets increased \$128,981,480 due to additional construction in progress related to the pipeline plus the year's capitalized interest cost.
- Payable from restricted assets decreased by \$9,381,430 due to reduced accounts payable at year end compared to the previous year.
- Net position increased \$1,191,553.

Karegnondi Water Authority

Management's Discussion and Analysis (Continued)

Statement of Revenue, Expenses, and Changes in Net Position

- Bond issuance costs increased \$563,218 related to new debt which was issued during the year.

Operating Revenue

The KWA's two water purchase customers, the City of Flint and the Genesee County Drain Commissioner as County Agency, have made 100 percent of their water supply contract operating subsidy good faith payments on time. These operating subsidies totaled \$1,938,000 in fiscal year 2015 and \$1,938,000 in fiscal year 2016.

Contacting Management

This financial report is intended to provide our constituents, future water users, and bondholders with a general overview of the Karegnondi Water Authority's accountability for the money it receives. If there are questions about this report or if additional information is needed, we welcome anyone to contact the CEO.

Karegnondi Water Authority

Statement of Net Position

	September 30, 2016	September 30, 2015
Assets		
Current assets:		
Cash and cash equivalents (Note 2)	\$ 7,159,901	\$ 5,396,585
Receivables:		
Accrued interest receivable	74,117	120,008
Other receivables	-	53,500
Due from other governmental units	33,534	33,534
Total current assets	7,267,552	5,603,627
Noncurrent assets:		
Restricted assets (Note 3)	45,429,465	108,590,629
Capital assets - Assets not subject to depreciation (Note 4)	310,377,287	181,395,807
Total noncurrent assets	355,806,752	289,986,436
Total assets	363,074,304	295,590,063
Liabilities		
Current liabilities - Accounts payable	18,575	10,031
Noncurrent liabilities:		
Payable from restricted assets (Note 1)	12,573,368	21,954,798
Lease interest payable	5,118,032	3,428,607
Long-term debt (Note 5)	340,503,990	266,527,841
Total noncurrent liabilities	358,195,390	291,911,246
Total liabilities	358,213,965	291,921,277
Equity - Net position		
Net investment in capital assets	2,729,394	1,557,297
Unrestricted	2,130,945	2,111,489
Total net position	\$ 4,860,339	\$ 3,668,786

Karegnondi Water Authority

Statement of Revenue, Expenses, and Changes in Net Position

	Years Ended	
	September 30, 2016	September 30, 2015
Operating Expenses		
Office supplies and insurance	\$ 4,186	\$ 4,792
Professional services	190,313	136,192
Total operating expenses	194,499	140,984
Operating Loss	(194,499)	(140,984)
Nonoperating Revenue (Expenses)		
Water supply contract operating subsidy	1,938,000	1,938,000
Bond issuance costs	(563,218)	-
Investment income	11,270	4,813
Total nonoperating revenue	1,386,052	1,942,813
Change in Net Position	1,191,553	1,801,829
Net Position - Beginning of year	3,668,786	1,866,957
Net Position - End of year	\$ 4,860,339	\$ 3,668,786

Karegnondi Water Authority

Statement of Cash Flows

	Years Ended	
	September 30, 2016	September 30, 2015
Cash Flows from Operating Activities		
Payments to suppliers	\$ (185,955)	\$ (133,761)
Other payments	-	(33,534)
Net cash used in operating activities	(185,955)	(167,295)
Cash Flows from Noncapital Financing Activities - Water supply contract operating subsidy	1,938,000	1,938,000
Cash Flows from Capital and Related Financing Activities		
Bond proceeds received	74,370,000	-
Purchase of capital assets	(126,489,885)	(57,174,780)
Interest paid on capital debt (from capitalized interest account)	(11,036,205)	(11,591,131)
Bond issuance costs	(563,218)	-
Net cash used in capital and related financing activities	(63,719,308)	(68,765,911)
Cash Flows from Investing Activities		
Investment income	569,415	433,098
Proceeds from sale and maturities of investment securities	68,908,919	61,024,650
Net cash provided by investing activities	69,478,334	61,457,748
Net Increase (Decrease) in Cash and Cash Equivalents	7,511,071	(5,537,458)
Cash and Cash Equivalents - Beginning of year	11,458,659	16,996,117
Cash and Cash Equivalents - End of year	\$ 18,969,730	\$ 11,458,659
Statement of Net Position Classification of Cash and Cash Equivalents		
Cash and cash equivalents	\$ 7,159,901	\$ 5,396,585
Restricted assets	45,429,465	108,590,629
Less amounts classified as investments	(33,619,636)	(102,528,555)
Total cash and cash equivalents	\$ 18,969,730	\$ 11,458,659
Reconciliation of Operating Loss to Net Cash from Operating Activities		
Operating loss	\$ (194,499)	\$ (140,984)
Changes in assets and liabilities:		
Receivables	-	(33,534)
Accounts payable	8,544	7,223
Net cash used in operating activities	\$ (185,955)	\$ (167,295)

Noncash Investing, Capital, and Financing Activities - During the year ended September 30, 2016, there were no noncash activities. During the year ended September 30, 2015, the Authority recorded \$4,625,646 of capital assets related to a capital lease. During the year ended September 30, 2015, the Authority also recorded \$33,960,593 of capital assets related to the drawdown of deposits with a pipe supplier.

Karegnondi Water Authority

Notes to Financial Statements September 30, 2016 and 2015

Note I - Summary of Significant Accounting Policies

The following is a summary of the significant accounting policies used by Karegnondi Water Authority (KWA or the "Authority"):

Reporting Entity

Karegnondi Water Authority is governed by an appointed 15-member board and was created pursuant to Act 233, *Michigan Public Acts of 1955*. Its purpose is to acquire and operate a water pipeline that provides water to the Genesee County Drain Commission and the City of Flint, which in turn will treat the water to be provided to their residents. The Authority may also provide water to other local units in Lapeer and Sanilac counties. The Genesee County Drain Commissioner has financial accountability for KWA. This is subject to change based upon redistribution of capacity units.

Accounting and Reporting Principles

The Authority follows accounting principles generally accepted in the United States of America (GAAP) as applicable to governmental units. Accounting and financial reporting pronouncements are promulgated by the Governmental Accounting Standards Board.

Fund Accounting

The Authority accounts for its various activities in an enterprise fund in order to demonstrate accountability for how we have spent certain resources.

Proprietary Fund - The proprietary fund includes an enterprise fund, which provides goods or services to users in exchange for charges or fees. The Authority only has one fund, the Water Fund, which will provide water to customers through a pipeline to be constructed from Lake Huron. The pipeline is currently under construction and water is expected to be delivered subsequently.

Basis of Accounting

Proprietary funds use the economic resources measurement focus and the full-accrual basis of accounting. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

Report Presentation

This report includes the fund-based statements of the Authority. In accordance with government accounting principles, a government-wide presentation with program and general revenue is not applicable to special purpose governments engaged only in business-type activities.

Karegnondi Water Authority

Notes to Financial Statements September 30, 2016 and 2015

Note I - Summary of Significant Accounting Policies (Continued)

Specific Balances and Transactions

Cash and Cash Equivalents - Cash and cash equivalents include cash on hand, demand deposits, and short-term investments with a maturity of three months or less when acquired.

Investments - Investments are reported at fair value or estimated fair value. Short-term investments are reported at cost, which approximates fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates.

Prepaid Items - Certain payments to vendors reflect costs applicable to future fiscal years and are recorded as prepaid items in the fund financial statements.

Restricted Assets - The Authority's bond indenture requires amounts to be set aside in a construction account and a debt service reserve. These amounts have been classified as restricted assets, as well as amounts on deposit at the county being held for the construction or debt service of Karegnondi Water Authority water lines.

Liabilities Payable from Restricted Assets - The portion of interest due on the 2014A Water Supply System Bonds and the 2016 Water Supply System Bonds within the next year will be payable from these restricted assets and therefore has been reported as a noncurrent liability. The construction accounts payable will also be liquidated from the construction account and have been reported in this category.

Capital Assets - Capital assets are defined by the Authority as assets with an initial individual cost of more than \$10,000 and an estimated useful life in excess of one year. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at acquisition value at the date of donation. Currently, the Authority is in the process of constructing a water transmission line from Lake Huron; these costs are being reported as construction in progress during construction, after which time they will be depreciated over their estimated useful lives.

Interest incurred during the construction of capital assets of business-type activities is included as part of the capitalized value of the assets constructed. Interest expense (net of interest income) of \$13,349,049 and \$12,896,908 was capitalized as part of the cost of assets under construction for the years ended September 30, 2016 and 2015, respectively.

Long-term Obligations - Bond premiums are deferred and amortized over the life of the bonds using the effective interest method; bonds payable are reported net of the applicable bond premium. Bond issuance costs are expensed at the time they are incurred.

Karegnondi Water Authority

Notes to Financial Statements September 30, 2016 and 2015

Note 1 - Summary of Significant Accounting Policies (Continued)

Net Position Flow Assumption - Sometimes the government will fund outlays for a particular purpose from both restricted (e.g., restricted bond or grant proceeds) and unrestricted resources. In order to calculate the amounts to report as restricted - net position and unrestricted - net position in the government-wide and proprietary fund financial statements, a flow assumption must be made about the order in which the resources are considered to be applied. It is the government's policy to consider restricted - net position to have been depleted before unrestricted - net position is applied.

Proprietary Funds Operating Classification - Proprietary funds distinguish operating revenue and expenses from nonoperating items. Operating revenue and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenue of the Water Fund is charges to customers for sales and services. Operating expenses for enterprise fund include the cost of sales and services and administrative expenses. All revenue and expenses not meeting this definition are reported as nonoperating revenue and expenses.

Use of Estimates - 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 disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the period. Actual results could differ from those estimates.

Note 2 - Deposits and Investments

Deposits and investments are reported in the financial statements as of September 30, 2016 and 2015 as follows:

	<u>2016</u>	<u>2015</u>
Cash and cash equivalents	\$ 7,159,901	\$ 5,396,585
Restricted assets	<u>45,429,465</u>	<u>108,590,629</u>
Total	<u>\$ 52,589,366</u>	<u>\$ 113,987,214</u>

Karegnondi Water Authority

Notes to Financial Statements September 30, 2016 and 2015

Note 2 - Deposits and Investments (Continued)

These amounts are classified into the following deposits and investment categories:

	Primary Government 2016	Primary Government 2015
Cash deposits with financial institutions	\$ 18,069,730	\$ 10,658,659
Investments - Certificates of deposit (with maturities in excess of 90 days)	5,563,744	16,691,231
Investments - Money markets	28,055,892	15,735,330
Investments - Repurchase agreements (with maturities in excess of 90 days)	-	70,101,994
Total	<u>\$ 51,689,366</u>	<u>\$ 113,187,214</u>

Michigan Compiled Laws Section 129.91 (Public Act 20 of 1943, as amended) authorizes local governmental units to make deposits and invest in the accounts of federally insured banks, credit unions, and savings and loan associations that have offices in Michigan. The law also allows investments outside the state of Michigan when fully insured. The local unit is allowed to invest in bonds, securities, and other direct obligations of the United States or any agency or instrumentality of the United States; repurchase agreements; bankers' acceptances of United States banks; commercial paper rated within the two highest classifications, which matures not more than 270 days after the date of purchase; obligations of the State of Michigan or its political subdivisions, which are rated as investment grade; and mutual funds composed of investment vehicles that are legal for direct investment by local units of government in Michigan.

The Authority has designated three banks for the deposit of its funds. The investment policy adopted by the board in accordance with Public Act 196 of 1997 has authorized investment in bonds and securities of the United States government and bank accounts and CDs, but not the remainder of state statutory authority as listed above. The Authority's deposits and investment policies are in accordance with statutory authority.

The Authority's cash and investments are subject to several types of risk, which are examined in more detail below:

Custodial Credit Risk of Bank Deposits - Custodial credit risk is the risk that in the event of a bank failure, the Authority's deposits may not be returned to it. The Authority does not have a deposit policy for custodial credit risk. For the years ended September 30, 2016 and 2015, the Authority had \$17,942,717 and \$18,442,408 (checking and savings accounts) that were not fully insured or collateralized, respectively.

Karegnondi Water Authority

Notes to Financial Statements September 30, 2016 and 2015

Note 2 - Deposits and Investments (Continued)

Custodial Credit Risk of Investments - Custodial credit risk is the risk that, in the event of the failure of the counterparty, the Authority will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Authority does not have a policy for custodial credit risk. For the years ended September 30, 2016 and 2015, \$0 and \$70,101,994, respectively, of investment securities were uninsured and unregistered, but were collateralized by the counterparty or by its trust department or agent, but not in the Authority's name.

Investment Type	Carrying Value 2016	Carrying Value 2015	How Held
Repurchase agreements	\$ -	\$ 70,101,994	Agent

Interest Rate Risk - Interest rate risk is the risk that the value of investments will decrease as a result of a rise in interest rates. The Authority's investment policy does not restrict investment maturities, other than commercial paper, which can only be purchased with a 270-day maturity.

During the year ended September 30, 2016, the Authority liquidated all repurchase agreement investments. For the year ended September 30, 2015, the Authority had the following investments:

Investment	Fair Value	Weighted Average Maturity (Years)
2015 - Authority - Repurchase agreement	\$ 70,101,994	.71

Concentration of Credit Risk - The Authority places no limit on the amount it may invest in any one issuer. For the year ended September 30, 2015, more than 68 percent of the Authority's investments are in a repurchase agreement with Deutsche Bank AG. These investments are 68 percent the Authority's total investments as of September 30, 2015. As of September 30, 2016, the Authority no longer had any investments in a repurchase agreement with Deutsche Bank AG.

The Authority categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets, Level 2 inputs are significant other observable inputs, and Level 3 inputs are significant unobservable inputs. Investments that are measured at fair value using the net asset value per share (or its equivalent) as a practical expedient are not classified in the fair value hierarchy. As of September 30, 2016 and 2015, all cash and investments owned by the Authority are properly valued at cost; therefore, there is no fair value hierarchy applicable.

Karegnondi Water Authority

Notes to Financial Statements September 30, 2016 and 2015

Note 3 - Restricted Assets

The restricted assets are restricted for the following purposes:

	<u>2016</u>	<u>2015</u>
Unspent bond proceeds and related interest	\$ 10,909,829	\$ 75,364,068
County deposits	900,000	800,000
General obligation bond restrictions:		
Debt reserve	16,187,952	15,735,330
Debt retirement	<u>17,431,684</u>	<u>16,691,231</u>
Total restricted assets	<u>\$ 45,429,465</u>	<u>\$ 108,590,629</u>

Note 4 - Capital Assets

Capital asset activity of the Authority's business-type activities for the years ended September 30, 2016 and 2015 was as follows:

Business-type Activities	<u>Balance October 1, 2015</u>	<u>Additions</u>	<u>Disposals</u>	<u>Balance September 30, 2016</u>
Capital assets not being depreciated - Construction in progress	<u>\$ 181,395,807</u>	<u>\$ 128,981,480</u>	<u>\$ -</u>	<u>\$ 310,377,287</u>
	<u>Balance October 1, 2014</u>	<u>Additions</u>	<u>Disposals</u>	<u>Balance September 1, 2015</u>
Capital assets not being depreciated - Construction in progress	<u>\$ 60,169,807</u>	<u>\$ 121,226,000</u>	<u>\$ -</u>	<u>\$ 181,395,807</u>

Construction Commitments - The Authority has an active construction project at year end. The project is to complete the water pipeline. At year end, the Authority's commitment with contractors is as follows:

	<u>Spent to Date</u>	<u>Remaining Commitment</u>
Water pipeline	\$ 248,189,580	\$ 12,381,633

Karegnondi Water Authority

Notes to Financial Statements September 30, 2016 and 2015

Note 5 - Long-term Debt

The Authority issues bonds to provide for the acquisition and construction of major capital facilities. General obligation bonds are direct obligations and pledge the full faith and credit of the Authority.

Description	Amount
Business-type Activities	
2014A Water Supply System Bond, used to construct water pipeline, bearing interest from 3 percent to 5.25 percent, maturing in 2043	\$ 220,500,000
2016 Water Supply System Bond, used to construct water pipeline, bearing interest on the first of each month at a variable annual rate of 3.15 percent plus 70 percent of the 30-day LIBOR, maturing in 2018	<u>74,370,000</u>
Total	<u>\$ 294,870,000</u>

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Business-type Activities - 2016					
Bonds	\$220,500,000	\$ 74,370,000	\$ -	\$294,870,000	\$ -
Plus deferred amounts - Issuance premiums	<u>11,027,841</u>	<u>-</u>	<u>393,851</u>	<u>10,633,990</u>	<u>-</u>
Total bonds payable	231,527,841	74,370,000	393,851	305,503,990	-
Capital lease (Note 6)	<u>35,000,000</u>	<u>-</u>	<u>-</u>	<u>35,000,000</u>	<u>-</u>
Total business-type activities - 2016	<u>\$266,527,841</u>	<u>\$ 74,370,000</u>	<u>\$ 393,851</u>	<u>\$340,503,990</u>	<u>\$ -</u>

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Business-type Activities - 2015					
Bonds	\$220,500,000	\$ -	\$ -	\$220,500,000	\$ -
Plus deferred amounts - Issuance premiums	<u>11,421,693</u>	<u>-</u>	<u>393,852</u>	<u>11,027,841</u>	<u>-</u>
Total bonds payable	231,921,693	-	393,852	231,527,841	-
Capital lease (Note 6)	<u>35,000,000</u>	<u>-</u>	<u>-</u>	<u>35,000,000</u>	<u>-</u>
Total business-type activities - 2015	<u>\$266,921,693</u>	<u>\$ -</u>	<u>\$ 393,852</u>	<u>\$266,527,841</u>	<u>\$ -</u>

Karegnondi Water Authority

Notes to Financial Statements September 30, 2016 and 2015

Note 5 - Long-term Debt (Continued)

Total interest expense for the years ended September 30, 2016 and 2015 was \$13,907,194, of which \$13,349,049 (interest expense net of interest income) was capitalized, and \$13,493,055, of which \$12,896,908 (interest expense net of interest income), was capitalized, respectively.

Annual debt service requirements to maturity for the above bonds and note obligations are as follows:

Years Ending September 30	Business-type Activities		
	Principal	Interest	Total
2017	\$ -	\$ 14,361,491	\$ 14,361,491
2018	78,475,000	14,928,113	93,403,113
2019	4,275,000	10,861,863	15,136,863
2020	4,475,000	10,669,613	15,144,613
2021	4,655,000	10,471,363	15,126,363
2022-2026	26,740,000	48,788,938	75,528,938
2027-2031	34,180,000	41,105,344	75,285,344
2032-2036	43,990,000	31,062,075	75,052,075
2037-2041	56,590,000	18,103,650	74,693,650
2042-2044	41,490,000	3,179,250	44,669,250
Total	<u>\$ 294,870,000</u>	<u>\$ 203,531,700</u>	<u>\$ 498,401,700</u>

Karegnondi Water Authority

Notes to Financial Statements September 30, 2016 and 2015

Note 6 - Capital Lease

Capital Leases - The Authority has entered into a lease agreement as lessee for financing the purchase of the intake pump station. This lease agreement qualifies as a capital lease for accounting purposes and therefore, has been recorded at the present value of the future minimum lease payments as of the inception date. The future minimum lease obligations and the net present value are as follows:

<u>Years Ending September 30</u>	<u>Amount</u>
2017	\$ 831,093
2018	2,509,887
2019	2,509,587
2020	2,507,888
2021	2,504,813
2022-2026	12,494,063
2027-2031	12,451,444
2032-2036	12,392,859
2037-2041	13,298,926
2042-2044	<u>1,683,694</u>
Total minimum lease payments	63,184,254
Less amount representing interest	<u>(28,184,254)</u>
Present value	<u>\$ 35,000,000</u>

Note 7 - Water Supply Contract Operating Subsidy

Understanding that the goal of the Authority is to provide water to both the City of Flint and Genesee County Drain Commission (the "local units"), the local units have agreed to pay the Authority a good faith payment equal to \$32,300 per unit of water that the local unit has contractually agreed to purchase once the pipeline is fully operational. The City of Flint and Genesee County Drain Commission have contractually agreed to purchase 18 and 42 units, respectively, on a yearly basis. The yearly good faith payment will be paid through monthly installments and resulted in cash flows of \$1,938,000 to the Authority for the years ended September 30, 2016 and 2015. When the pipeline becomes fully operational, the monthly payments will be suspended and the contract with the local units indicates that a credit will be given on their monthly bills to return the funds contributed to the Authority. The terms of the repayment will be decided by the board of directors at the time that the pipeline is operational; however, the funds must be repaid within a maximum of 40 years.

Karegnondi Water Authority

Notes to Financial Statements September 30, 2016 and 2015

Note 8 - Related Party Transactions

The 2014A and 2016 Water Supply System Bonds of Karegnondi Water Authority are guaranteed through 2043 by both Genesee County and the City of Flint in the amounts of 66 percent and 34 percent, respectively, in accordance with the Karegnondi Water Authority Financing Contract. The Genesee County Division of Water and Waste Services provides management of the day-to-day operations of Karegnondi Water Authority, for which it allocates a portion of the costs to the Authority. Water and Waste Services has also issued \$35 million of bonds that it is using to construct the water intake and related pumps that KWA will use to bring water into its pipes to be transmitted to the water treatment plants by the City of Flint and the Division of Water and Waste Services. Once the bonds are redeemed, the title to the water intake and related pumps will be transferred to KWA.