

**CENTRAL COAST WATER AUTHORITY**

**ANNUAL FINANCIAL STATEMENTS**

**JUNE 30, 1996 AND 1995**

**(WITH INDEPENDENT AUDITORS'  
REPORT THEREON)**

# NASIF, HICKS, HARRIS & CO.

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## Independent Auditors' Report

To the Member Agencies of the  
Central Coast Water Authority

We have audited the accompanying balance sheets of the Central Coast Water Authority as of June 30, 1996 and 1995, and the related statements of revenues, expenses and changes in retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the management of the Central Coast Water Authority. Our responsibility is to express an opinion on these financial statements based upon our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the 1996 and 1995 financial statements referred to above present fairly, in all material respects, the financial position of Central Coast Water Authority as of June 30, 1996 and 1995, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

  
Nasif, Hicks, Harris & Co.

August 14, 1996

Central Coast Water Authority  
Balance Sheets  
June 30,

ASSETS

	<u>1996</u>	<u>1995</u>
<b>Current Assets:</b>		
Cash and investments (Note 2)	\$ 4,757,615	\$ 1,542,931
Accounts receivable	2,802,445	1,399,672
Accrued interest receivable	826,665	1,020,729
	-----	-----
<b>Total Current Assets</b>	<b>8,386,725</b>	<b>3,963,332</b>
	-----	-----
<b>Restricted Assets:</b>		
Cash and investments with fiscal agents (Note 2)	78,241,789	119,345,823
Cash and investments held for deposits	8,509,358	3,872,365
	-----	-----
<b>Total Restricted Assets</b>	<b>86,751,147</b>	<b>123,218,188</b>
	-----	-----
Property, Plant and Equipment (Note 3)	139,942,884	100,624,461
Less: Accumulated depreciation	(140,875)	(78,687)
	-----	-----
<b>Net Property, Plant and Equipment</b>	<b>139,802,009</b>	<b>100,545,774</b>
	-----	-----
Unamortized Bond Issuance Costs (Note 1)	3,203,085	3,389,295
	-----	-----
<b>TOTAL ASSETS</b>	<b>\$238,142,966</b>	<b>\$231,116,589</b>
	=====	=====

See Notes to Financial Statements.

Central Coast Water Authority  
Balance Sheets  
June 30,

LIABILITIES AND FUND EQUITY

	<u>1996</u>	<u>1995</u>
<b>Current Liabilities:</b>		
Accounts payable	\$ 3,849,182	\$ 4,264,751
Deposits	8,509,358	3,872,365
Accrued interest payable	2,822,533	2,822,533
Retainage payable	84,231	554,453
Prepaid member assessments	675,991	---
	-----	-----
<b>Total Current Liabilities</b>	<b>15,941,295</b>	<b>11,514,102</b>
	-----	-----
<b>Long-Term Liabilities:</b>		
Deferred compensation payable (Note 2)	160,690	109,476
Bonds payable (Note 4)	177,120,000	177,120,000
	-----	-----
<b>Total Long-Term Liabilities</b>	<b>177,280,690</b>	<b>177,229,476</b>
	-----	-----
<b>Total Liabilities</b>	<b>193,221,985</b>	<b>188,743,578</b>
	-----	-----
<b>Commitments and Uncertainties (Note 5)</b>		
<b>Fund Equity:</b>		
Contributed capital, net (Note 6)	35,580,945	35,004,281
Retained earnings	9,340,036	7,368,730
	-----	-----
<b>Total Fund Equity</b>	<b>44,920,981</b>	<b>42,373,011</b>
	-----	-----
<b>TOTAL LIABILITIES AND FUND EQUITY</b>	<b>\$238,142,966</b>	<b>\$231,116,589</b>
	=====	=====

See Notes to Financial Statements.

Central Coast Water Authority  
 Statements of Revenues, Expenses and  
 Changes in Retained Earnings  
 Years Ended June 30,

	<u>1996</u>	<u>1995</u>
Operating Revenues:		
Operating reimbursements from member agencies	\$1,798,493	\$1,364,258
Other revenues	2,713	1,142
	-----	-----
Total Operating Revenues	1,801,206	1,365,400
	-----	-----
Operating Expenses:		
Administration	462,971	387,546
Accounting	41,456	13,035
Communications	16,102	11,948
Consultants	51,826	34,904
Depreciation	62,188	53,079
Dues and memberships	10,346	8,006
Equipment maintenance	12,104	6,265
Insurance	31,511	22,904
Legal	193,863	105,882
Office expense	17,424	18,551
Rents	53,116	60,720
Small tools and software	6,722	19,526
Transportation and travel	14,356	20,460
Equipment	1,018	---
	-----	-----
Total Operating Expenses	975,003	762,826
	-----	-----
Operating Income	826,203	602,574
Nonoperating Revenue - interest income	1,145,103	1,665,769
	-----	-----
Net Income	1,971,306	2,268,343
Retained Earnings, beginning of year	7,368,730	5,100,387
	-----	-----
Retained Earnings, end of year	<u>\$9,340,036</u>	<u>\$7,368,730</u>

See Notes to Financial Statements.

Central Coast Water Authority  
Statements of Cash Flows  
Years Ended June 30,

	<u>1996</u>	<u>1995</u>
<b>Cash Flows From Operating Activities:</b>		
Cash received from member agencies	\$1,797,132	\$1,362,809
Cash payments for goods and services	(885,997)	(729,321)
Other operating revenues	2,713	1,142
Reimbursement of costs	234,458	(978,394)
Prepaid member assessments	675,991	---
	-----	-----
Net cash provided (used) by operating activities	1,824,297	(343,764)
	-----	-----
<b>Cash flows from non-capital financing activities:</b>		
Cash received for deposits	4,636,993	835,859
Increase in deferred compensation payable	51,214	41,060
	-----	-----
Net cash provided by non-capital financing activities	4,688,207	876,919
	-----	-----
<b>Cash flows from capital and related financing activities:</b>		
Acquisition of capital assets	(41,210,470)	(64,858,103)
Increase (decrease) in contributed capital	576,664	(1,010,945)
Decrease in retainage payable	(470,222)	(769,755)
	-----	-----
Net cash used by capital and related financing activities	(41,104,028)	(66,638,803)
	-----	-----
<b>Cash flows from investing activities:</b>		
Decrease in cash with fiscal agent	41,104,034	63,334,462
Interest and dividends on investments	1,145,103	1,665,769
Decrease in accrued interest receivable	194,064	648,939
	-----	-----
Net cash provided from investing activities	42,443,201	65,649,170
	-----	-----
Net increase (decrease) in cash and cash equivalents	7,851,677	(456,478)
	-----	-----
Cash and cash equivalents, beginning of year	5,415,296	5,871,774
	-----	-----
Cash and cash equivalents, end of year	<u>\$13,266,973</u>	<u>\$5,415,296</u>

See Notes to Financial Statements.

Central Coast Water Authority  
 Statements of Cash Flows  
 Years Ended June 30,

	<u>1996</u>	<u>1995</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 826,203	\$ 602,574
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	62,188	53,079
Changes in assets and liabilities:		
Increase in accounts payable, net	1,662,688	395,329
Decrease in accounts receivable	(1,402,773)	(1,394,746)
Increase in prepaid member assessments	675,991	---
	-----	-----
Net cash provided (used) by operating activities	\$1,824,297	\$ (343,764)

See Notes to Financial Statements.

Central Coast Water Authority  
Notes to Financial Statements  
June 30, 1996 and 1995

Note 1: Summary of Significant Accounting Policies

The accounting policies of the Central Coast Water Authority ("Authority") conform to generally accepted accounting principles. The following summary of the Authority's more significant accounting policies is presented to assist the reader in interpreting the financial statements and other data in this report. These policies should be viewed as an integral part of the accompanying financial statements.

A. Reporting Entity

The primary purpose of the Central Coast Water Authority is to provide for the development, financing, construction, operation and maintenance of certain local (non-state owned) facilities required to deliver water from the State Water Project (the "SWP") to certain water purveyors and users in Santa Barbara County.

The Central Coast Water Authority was created by its members in August 1991. The Authority is presently composed of eight members, all of which are public agencies, as follows: the cities of Santa Maria, Santa Barbara, Guadalupe and Buellton, the Santa Ynez River Water Conservation District, Improvement District No. 1 ("SYRWCD, ID#1"), the Goleta Water District, the Montecito Water District, and the Carpinteria Valley Water District. In addition, the Authority has one associate member, the La Cumbre Mutual Water Company (together with the members, the "Purveyor Participants"). Each of the Purveyor Participants has entered into a Water Supply Agreement with the Authority, as have non-members: Vandenberg Air Force Base ("Vandenberg AFB"), Santa Barbara Research Company, Morehart Land Company and Southern California Water Company (the "Consumer Participants").

The Authority Participants are located in three different geographic areas of Santa Barbara County: North County (Vandenberg AFB, Santa Maria, Southern California Water Company and Guadalupe); the Santa Ynez Valley (Buellton and SYRWCD, ID#1); and the South Coast (Santa Barbara, Goleta, Montecito, Carpinteria, La Cumbre Mutual Water Company, Santa Barbara Research Company and Morehart Land Company). Historically, the North County has been an agricultural area but has seen significant urban development in the last ten years and expects



Central Coast Water Authority  
Notes to Financial Statements  
June 30, 1996 and 1995

Note 1: Summary of Significant Accounting Policies - Continued

A. Reporting Entity (continued)

additional urban development in the future; the Santa Ynez Valley is a rural agricultural area and tourist destination; and the South Coast is a generally developed urban area which does not expect significant growth in the future.

In October 1992 Central Coast Water Authority entered into an agreement with San Luis Obispo County to treat water delivered through the SWP. The entities covered by the agreement include: San Luis Obispo County, City of Pismo Beach, City of Morro Bay, Cuesta College, California Men's Colony, Oceano Community Services District, Avila Beach County Water District, County of San Luis Obispo Community Services Area #16, Irrigation District #1, Avila Valley Mutual Water Company, San Luis Coastal Unified School District and San Miguelito Mutual Water District.

Facilities To Be Constructed

The facilities being constructed by the Authority include a water treatment plant to be located at Polonio Pass in northern San Luis Obispo County and two pipeline extensions: (1) the Mission Hills Extension, a buried pipeline approximately eleven miles long running from the terminus of the Coastal Branch (Phase II) southerly to the vicinity of the Lompoc Valley, and (2) the Santa Ynez Extension, a buried pipeline approximately thirty-two miles long running from the terminus of the Mission Hills Extension easterly through the Santa Ynez Valley, to terminus at or near Cachuma Lake and includes one pumping plant near Santa Ynez and one storage tank. Water transported to Lake Cachuma will then be transported through the existing Tecolote Tunnel, which traverses the Santa Ynez Mountains, to the South Coast of Santa Barbara County.

The water treatment plant will receive raw water from the SWP and deliver treated water to purveyors and users located in San Luis Obispo and Santa Barbara Counties.

Central Coast Water Authority  
Notes to Financial Statements  
June 30, 1996 and 1995

Note 1: Summary of Significant Accounting Policies - Continued

Contractual Relationships

The State of California Department of Water Resources ("DWR") entered into contracts (the "State Water Supply Contracts") with San Luis Obispo and Santa Barbara Counties in 1963 pursuant to which the counties received entitlements to water from the SWP. San Luis Obispo County's entitlement was for 25,000 acre-feet per year and Santa Barbara County's entitlement was for 57,700 acre-feet per year. In 1981, Santa Barbara County amended its contract to reduce its entitlement to 45,486 acre-feet per year. San Luis Obispo is currently in the process of reducing its entitlement to 4,830 acre feet per year.

In 1983, Santa Barbara County entered into a series of Water Supply Retention Agreements ("WSRAs") with local water purveyors and users within Santa Barbara County. These WSRAs initially granted the purveyors and users an option to obtain an assignment of Santa Barbara County's State Water Supply Contract rights, and, as of July 1, 1989, actually granted the full assignment of those rights. Thereafter, certain of the local water purveyors and users holding the WSRA rights transferred those rights to the Authority, a newly formed joint powers authority, in consideration for Water Supply Agreements dated August 1, 1991, which provide for the delivery of SWP water by the Authority and the payment of required costs by the transferors. The Authority's obligation to make such payments to the DWR from the payments it receives pursuant to the Water Supply Agreements is senior to its obligation to make payments with respect to the Bonds. These transfers have been consented to by DWR and were validated by an agreement between Santa Barbara County and the Authority on November 12, 1991 (the "Transfer of Financial Responsibility Agreement").

The Water Supply Agreements

Each Project Participant has entered into a Water Supply Agreement in order to provide for the development, financing, construction, operation and maintenance of the Project. The purpose of the Water Supply Agreements is to assist in carrying out the purposes of the Authority with respect to the Project by: (1) requiring the Authority to sell, and the Project Participants to buy, a specified amount of water from the project, and (2) assigning the Project Participants' entitlement rights in the Project to the Authority.

Central Coast Water Authority  
Notes to Financial Statements  
June 30, 1996 and 1995

Note 1: Summary of Significant Accounting Policies - Continued

The Water Supply Agreements (continued)

In accordance with the provisions of each Water Supply Agreement, the Authority will fix charges for each Project Participant to produce revenues from the Project equal to the amounts anticipated to be needed by the Authority to meet the costs of the Authority to deliver to each Project Participant its pro rata share of water from the Project as set forth in each Water Supply Agreement. Each Project Participant is required to pay to the Authority an amount equal to its share of the total Fixed Project Costs and certain other costs in the proportion established in accordance with the applicable Water Supply Agreement, including the Santa Barbara Project Participant's share of payments to DWR under the State Water Supply Contract, as amended (including capital, operation, maintenance, power and replacement costs of the DWR Facilities), debt service on the Bonds and all Authority operating and administrative costs. Such obligation is to be honored by each Project Participant whether or not water is furnished to it from the Project at all times or not at all and whether or not the Project is completed, operable, operated or retired. Such payments are not subject to any reduction and are not conditioned upon performance by the Authority or any other Project Participant under any agreement.

The Water Supply Agreements set forth detailed provisions concerning the time and method of payment by each Contractor of certain costs, including Fixed Project Costs and other operation and maintenance costs, as well as the method of allocation of such costs and expenses and the remedies available to the Authority in the event a Contractor defaults in its payments to the authority.

B. Basis of Accounting

The Authority operates as a proprietary fund-type. All proprietary fund-types are accounted for on a flow of economic resources measurement focus. Under this measurement focus, all assets and liabilities associated with the operation of these funds are included on the balance sheet. Where appropriate, net total assets (i.e., fund equity) is segregated into contributed capital and retained earnings. Proprietary fund-type operating statements present increases (revenues) and decreases (expenses) in net total assets.

Central Coast Water Authority  
Notes to Financial Statements  
June 30, 1996 and 1995

Note 1: Summary of Significant Accounting Policies - Continued

B. Basis of Accounting (continued)

All proprietary fund-types utilize the accrual basis of accounting. Under this method, revenues are recognized when earned, regardless of when received, and expenses are recognized at the time the related liabilities are incurred, regardless of when paid.

C. Investments

The Authority has developed an investment policy that exceeds the minimum requirements established by the State of California. The Authority believes that it has adhered to established policies for all investment activities. Investments are classified as held-to-maturity and are stated at amortized cost. Investments have been purchased with maturity dates to coincide with cash needed to satisfy construction progress payments. Generally, all investments will mature within two years.

D. Property, Plant and Equipment

Property, plant and equipment purchased or constructed by the Authority is stated at cost. Depreciation has been provided over the estimated useful life of each asset using the straight-line method. Interest costs incurred in excess of related interest earned on proceeds from bonds have been capitalized. In addition, certain technical and engineering related studies associated with the Project have also been capitalized and will be amortized. The estimated useful life of depreciated assets is as follows:

Buildings	20-50 years
Improvements other than buildings	10-100 years
Equipment	3-12 years

E. Unamortized Bond Issuance Costs

Unamortized bond issuance costs are deferred and amortized over the term of the bonds using the bonds-outstanding method, which approximates the effective interest method (see Note 4).

Central Coast Water Authority  
Notes to Financial Statements  
June 30, 1996 and 1995

Note 1: Summary of Significant Accounting Policies - Continued

F. Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles 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 revenues and expenses during the reported period. Actual results could differ from those estimates.

Note 2: Cash and Investments

A. Demand Deposits

The Authority's demand deposits with a central California regional bank totaled \$8,055,481 and \$200,516 at June 30, 1996 and 1995, respectively. Such deposits are insured up to a maximum of \$100,000 by the Federal Deposit Insurance Corporation.

B. Cash and Investments

The Authority is authorized by its investment policy, in accordance with Section 53601 of the California Government Code, to invest in the following instruments: securities issued or guaranteed by the Federal Government or its agencies, commercial paper, and the State Treasurer's Local Agency Investment Funds (LAIF).

Based upon categories established to measure the level of custodial risk assumed by the Authority in its investments, the Authority's securities are considered category three investments. These are uninsured and unregistered investments for which the securities are held by the counterparty trust department or agent, but not specifically in the Authority's name. LAIF funds are not categorized.

Central Coast Water Authority  
Notes to Financial Statements  
June 30, 1996 and 1995

Note 2: Cash and Investments - Continued

C. Cash and Investments with Fiscal Agent

The Authority has monies held by trustees or fiscal agents pledged to the payment or security of the bonds payable. The California Government Code provides that these monies, in absence of specific statutory provisions governing the issuance of bonds or certificates, may be invested in accordance with the indentures specifying the types of investment the trustees or fiscal agents may make.

D. Cash Equivalents

The Authority considers all pooled cash and investments, except funds with fiscal agents, to be cash equivalents.

E. Deferred Compensation Plan

The Authority offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. Under the terms of this plan, employees may defer amounts of income up to a maximum of twenty five percent of salary or \$7,500 per year, whichever is less. Amounts so deferred may not be paid to the employee during employment with the Authority except for a catastrophic circumstance creating an undue and unforeseen financial hardship for the employee.

The plan provides for a wide range of investment alternatives, including deposits to savings and loan institutions, investments in mutual funds and insurance company annuity programs. Investments of the deferred compensation fund are stated at market value in accordance with the deferred compensation agreement. At June 30, 1996, net assets available in the fund amounted to \$160,690.

All amounts of compensation deferred under the plan, all property and rights purchased with those amounts, and all income attributable to those amounts, property or rights are, until paid or made available to the employee or other beneficiary, solely the property and rights of the Authority without being restricted to the provisions of benefits under the

Central Coast Water Authority  
Notes to Financial Statements  
June 30, 1996 and 1995

Note 2: Cash and Investments - Continued

E. Deferred Compensation Plan (continued)

plan, subject only to the claims of the Authority's general creditors. Participants' rights under the plan are equal to those of general creditors of the Authority in an amount equal to the fair market value of the deferred account for each participant.

It is the opinion of the Authority's legal counsel that the Authority has no liability for losses under the plan, but does have the duty of due care that would be required of an ordinary prudent investor. The Authority believes that it is unlikely that it will use the assets of the plan to satisfy the claims of general creditors in the future.

F. Pooling

The Authority follows the practice of pooling cash and investments for all funds under its direct daily control. Funds held by outside fiscal agents under provisions of the bond indenture are maintained separately. Interest income from cash and investments with fiscal agents is credited directly to the related accounts.

Central Coast Water Authority  
Notes to Financial Statements  
June 30, 1996 and 1995

Note 2: Cash and Investments - Continued

F. Pooling (continued)

The carrying and market values of cash and investments consisted of the following at June 30,

	1996		1995
	Carrying Amount	Market Value	Carrying Amount
<b>Cash and Investments</b>			
Cash in bank	\$ 8,055,481	\$ 8,055,481	\$ 200,517
Petty cash	1,200	1,200	1,000
Local Agency Investment Fund	5,210,292	5,210,292	5,213,779
	-----	-----	-----
	13,266,973	13,266,973	5,415,296
	-----	-----	-----
Less: cash and investments held for deposits	(8,509,358)	(8,509,358)	(3,872,365)
	-----	-----	-----
<b>Total Cash and Investments</b>	<b>4,757,615</b>	<b>4,757,615</b>	<b>1,542,931</b>
 <b>Cash and Investments with Fiscal Agents</b>			
Money market funds	2,653,301	2,653,301	4,457,705
Deferred compensation	160,690	160,690	109,476
Commercial paper	13,546,159	13,497,137	---
U.S. Government securities	49,342,810	49,397,368	96,049,642
Local Agency Investment Fund	12,538,829	12,538,829	18,729,000
	-----	-----	-----
<b>Total Cash and Investments     with Fiscal Agents</b>	<b>78,241,789</b>	<b>78,247,325</b>	<b>119,345,823</b>
	-----	-----	-----
<b>Total</b>	<b>\$91,508,762</b>	<b>\$91,514,298</b>	<b>\$124,761,119</b>
	=====	=====	=====



Central Coast Water Authority  
Notes to Financial Statements  
June 30, 1996 and 1995

Note 3: Property, Plant and Equipment

Construction in progress includes \$6,569,457 and \$5,241,623 of capitalized interest for June 30, 1996 and 1995, respectively. Property, plant and equipment is as follows at June 30,

	<u>1996</u>	<u>1995</u>
Equipment	\$ 356,647	\$ 275,500
Construction in progress	139,586,237	100,348,961
	-----	-----
Total property, plant and equipment	139,942,884	100,624,461
Accumulated depreciation	(140,875)	(78,687)
	-----	-----
Net property, plant and equipment	<u>\$139,802,009</u>	<u>\$100,545,774</u>

Note 4: Long-Term Debt

In October 1992 the Authority issued revenue bonds for the benefit of its participants to finance a portion of the costs of developing a pipeline and water treatment plant, to reimburse certain project participants for costs incurred in connection with the State Water Project, and to finance certain other facilities. Each of the participants in the financing held elections authorizing issuance of revenue bonds for the construction of the State Water Project. In order to reduce issuance costs and insure the proceeds are available on a timely basis, the Authority issued the bonds for all the participants requiring financing.

The City of Santa Maria, Vandenberg AFB, Southern California Water Company, Avila Valley Mutual Water Company, San Luis Coastal Unified School District, and San Miguelito Mutual Water District contributed cash for their proportionate share of the construction costs. Such net contributions totaling \$35,580,945 and \$35,004,281 at June 30, 1996 and 1995, respectively, have been accounted for as contributed capital. Under the Water Supply Agreements, each Project Participant is obligated to make payments to the Authority, with the payments pledged to secure the payment of the principal and interest of the bonds. The bonds are backed by a municipal bond insurance policy issued by AMBAC Indemnity. The Central Coast Water Authority Note, issued June 1992, in the amount of \$23,545,000 was advance refunded from proceeds of the bond issue. The October 1992 bonds were sold at interest ranging from 4.85% to 6.60%.

Central Coast Water Authority  
Notes to Financial Statements  
June 30, 1996 and 1995

Note 4: Long-Term Debt - Continued

The annual requirements to pay all debt outstanding, as of June 30, 1996, are as follows:

<u>Fiscal Year</u>	<u>Interest</u>	<u>Principal</u>	<u>Total</u>
1997	\$ 11,290,130	\$ ---	\$ 11,290,130
1998	11,217,623	2,990,000	14,207,623
1999	11,065,173	3,135,000	14,200,173
2000	10,897,912	3,295,000	14,192,912
2001	10,715,170	3,470,000	14,185,170
2002-2006	50,238,578	20,560,000	70,798,578
2007-2011	42,814,547	27,705,000	70,519,547
2012-2016	32,267,305	37,905,000	70,172,305
2017-2021	17,603,520	52,090,000	69,693,520
2022-2023	1,741,410	25,970,000	27,711,410
	-----	-----	-----
<b>Total</b>	<b>\$199,851,368</b>	<b>\$177,120,000</b>	<b>\$376,971,368</b>

Note 5: Commitments and Uncertainties

The Authority has entered into long-term contracts with prime contractors for consultation and the construction of the facilities described in Note 1. Remaining balances on construction contracts signed total \$8,436,643 at June 30, 1996.

The Authority leases its main office facility under an operating lease expiring July 31, 2000. Rent expense under the arrangement is \$6,611 per month. The lease provides for an annual CPI adjustment.

The Authority leases other equipment under non-cancelable operating leases.

Central Coast Water Authority  
Notes to Financial Statements  
June 30, 1996 and 1995

Note 5: Commitments and Uncertainties - Continued

Minimum rental commitments for these operating leases in effect at June 30, 1996 were:

Years ended June 30,	
1997	\$ 85,869
1998	85,992
1999	83,772
2000	79,332
Later years	6,611
	-----
Total minimum payments	\$341,576
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Rental expense for fiscal year 1996 and 1995 was \$84,345 and \$54,666, respectively.

The Authority is involved in various legal proceedings, lawsuits and claims of a nature considered normal for its activities. It is the Authority's policy to accrue for amounts related to these legal matters if it is probable that a liability has been incurred and an amount is reasonably estimable.

The Authority is also involved in a lawsuit, *City of Solvang v. Santa Ynez River Water Conservation District, Improvement District No. 1* (Santa Barbara County Superior Court No. SM 93289). The defendant in this action is one of the members of the Authority, and is obligated to take 2,000 acre feet of water per year from the State Water Project under a contract with the Authority. Plaintiff city seeks to limit or avoid its obligations under a separate contract it has with defendant to take 75% of defendant's entitlement from the State Water Project. If the plaintiff city prevails on one of its legal theories, part or all of the contract would be void and all other contracts for payment of water between the Authority and its members and other project participants may also be void. If such a decision were rendered, the Authority would be unable to meet its obligation to pay bondholders and litigation and enforcement activity would likely ensue. If the plaintiff city prevails on other theories, it will have limited or no obligations under its contract with defendants. In that event, defendant may

Central Coast Water Authority  
Notes to Financial Statements  
June 30, 1996 and 1995

Note 5: Commitments and Uncertainties - Continued

have difficulties in satisfying its obligations to the Authority to pay for its water entitlement. In such a situation, certain other members and project participants of the Authority may have to pay up to 25% more under their similar contracts with the Authority. Discovery is ongoing and no trial date has of yet been set. The ultimate outcome of this lawsuit is not possible to predict, and may not be resolved for a number of years.

While it is not possible to predict with certainty the outcome of these cases, it is the opinion of management that the lawsuits, claims and proceedings which are pending against the Authority are without merit or will not have a material adverse effect on the Authority's operating results, liquidity or financial position.

During the construction phase, pipeline and above ground improvements were insured against risk of loss under the provisions of contractors builders risk policies. At June 30, 1996, the Authority had accepted approximately twenty-six miles of pipeline. The Authority will not insure the underground improvements against casualty loss, but above ground improvements will be insured against casualty loss in a amount not to exceed \$4.3 million. The Authority carries \$40 million of excess liability insurance.

All of the accounts receivable recorded by the Authority are payable by its local participants and the DWR under the agreements more fully described in Note 1.

Central Coast Water Authority  
Notes to Financial Statements  
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Note 6: Contributed Capital

The following schedule provides changes in contributed capital for the fiscal year ended June 30, 1996:

	Beginning Balance 07/01/95	Additions	Refunds	Ending Balance 6/30/96
	-----	-----	-----	-----
Avila Valley	\$ 23,920		\$ ---	\$ 23,920
San Luis Schools	8,372			8,372
San Miguelito	328,900			328,900
Santa Maria	19,549,000			19,549,000
Vandenberg AFB	14,447,127			14,447,127
SoCal Water	646,962	\$353,360		1,000,322
Santa Ynez		142,185		142,185
Guadalupe		81,119		81,119
	-----	-----	-----	-----
Totals	\$35,004,281	\$576,664	\$ ---	\$35,580,945
	=====	=====	=====	=====