

**MODESTO IRRIGATION DISTRICT
FINANCING AUTHORITY**

(A Component Unit of Modesto Irrigation District)

FINANCIAL STATEMENTS

Including Independent Auditors' Report

As of and for the Years Ended December 31, 2012 and 2011

MODESTO IRRIGATION DISTRICT FINANCING AUTHORITY
(A Component Unit of Modesto Irrigation District)

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Modesto Irrigation District Financing Authority
Modesto, California

Report on the Financial Statements

We have audited the accompanying financial statements of Modesto Irrigation District Financing Authority (the Authority), a component unit of Modesto Irrigation District, as of and for the years ended December 31, 2012 and 2011, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express 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 auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Authority'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 Authority'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
Modesto Irrigation District Financing Authority

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Authority as of December 31, 2012 and 2011, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in the Note 2, the Authority has adopted the provisions of GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, effective January 1, 2012. Our opinion is not modified with respect to this matter.

Other Matter

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

Baker Gilly Viechow Krause, LLP

Madison, Wisconsin
May 6, 2013

MODESTO IRRIGATION DISTRICT FINANCING AUTHORITY

(A Component Unit of Modesto Irrigation District)

MANAGEMENT'S DISCUSSION AND ANALYSIS

Years Ended December 31, 2012 and 2011

(Dollars in Thousands)

Unaudited

Overview

The following management discussion and analysis of the Modesto Irrigation District Financing Authority (the Authority) provides an overview of the financial activities and transactions for the fiscal year 2012 and 2011 in the context of the requirements of the Statement of Governmental Accounting Standards (SGAS) Statement No. 34, Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments, as amended. This discussion and analysis should be read in conjunction with the Authority's audited financial statements and accompanying notes.

Organization and Purpose

The purpose of the Authority is to provide financing and contracting for public capital improvements in accordance with the law, including the refinancing of prior indebtedness, for the Modesto Irrigation District (the District). The District's Board of Directors is designated to serve in the same capacity for the Authority.

Financial Reporting

The Authority's accounting records are maintained under the accrual method of accounting in accordance with generally accepted accounting principles for proprietary funds as prescribed by the Governmental Accounting Standards Board (GASB) and, where not in conflict with GASB pronouncements, accounting principles prescribed by the Financial Accounting Standards Board (FASB). The Authority's accounts are included as a component unit in the consolidated financial statements of the District.

Explanation of Financial Statements

The Authority's financial statements include a Balance Sheet, Statement of Revenues, Expenses and Changes in Net Position, and a Statement of Cash Flows. The Balance Sheet provides information about assets and obligations of the Authority at a specific point in time. The Statement of Revenues, Expenses and Changes in Net Position provides information regarding the Authority's operations during the fiscal year. The Statement of Cash Flows reports cash sources and uses for capital and investing activities during the fiscal year.

MODESTO IRRIGATION DISTRICT FINANCING AUTHORITY
(A Component Unit of Modesto Irrigation District)

MANAGEMENT'S DISCUSSION AND ANALYSIS
Years Ended December 31, 2012 and 2011
(Dollars in Thousands)
Unaudited

Financial Summary

<i>Dollars in Thousands</i>	December 31, 2012	December 31, 2011	December 31, 2010	Change from 2011 to 2012
Assets and Deferred Outflows				
Current Assets	\$ 8,285	\$ 7,839	\$ 8,552	\$ 446
Other assets	17,397	33,232	62,365	(15,835)
Debt service installment receivable				
Less: Current portion	221,169	210,208	183,788	10,961
Deferred cash flow hedges	32,190	34,518	16,710	(2,328)
	<u>279,041</u>	<u>285,797</u>	<u>271,415</u>	<u>(6,756)</u>
Liabilities and Net Position				
Current liabilities	7,928	7,800	7,674	128
Noncurrent liabilities	32,226	35,347	17,539	(3,121)
Long-term debt	238,887	242,650	246,202	(3,763)
	<u>279,041</u>	<u>285,797</u>	<u>271,415</u>	<u>(6,756)</u>
Non-Operating Revenues and Expenses				
Revenues				
Debt service contributions	10,628	11,445	9,350	(817)
Other non-operating revenues	1,937	2,087	1,444	(150)
	<u>12,565</u>	<u>13,532</u>	<u>10,794</u>	<u>(967)</u>
Interest expense	<u>(12,565)</u>	<u>(13,532)</u>	<u>(10,794)</u>	<u>967</u>
Net Position – End of Year	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

ASSETS

Assets of the Financing Authority consist primarily of debt service received from the District and long-term investments. Assets decreased by \$6.7 million for the fiscal year 2012 from 2011. The District's debt service obligation to the Financing Authority directly corresponds to the Financing Authority's outstanding debt and the long-term investments. The decrease is primarily due to the completion of the Lodi Energy Center project.

Assets increased by \$14.4 million in 2011 over 2010. The District's debt service obligation to the Authority directly corresponds to the Authority's outstanding debt and the long-term investments.

MODESTO IRRIGATION DISTRICT FINANCING AUTHORITY

(A Component Unit of Modesto Irrigation District)

MANAGEMENT'S DISCUSSION AND ANALYSIS

Years Ended December 31, 2012 and 2011

(Dollars in Thousands)

Unaudited

LIABILITIES

Long-Term Debt

Long-term debt decreased by \$3.8 million in 2012 over 2011, as a result of the scheduled debt payments.

Long-term debt decreased by \$3.5 million in 2011 over 2010, as a result of the scheduled debt payments.

Current Liabilities

Current liabilities increased in 2012 from 2011 by \$0.1 million. This increase was the result of an increase in the current portion of long-term debt scheduled to be paid in the following year offset by the decrease of interest payable due to the repayment of debt.

Current liabilities increased in 2011 from 2010 by \$0.1 million. This increase was the result of an increase in the current portion of long-term debt scheduled to be paid in the following year offset by the decrease of interest payable due to the repayment of debt.

Non-Operational Revenue and Expenses

Revenues

Debt service contributions reported as revenue represent the portion of payments received from the District each year that are attributable to the Authority's interest expense on its outstanding debt. The Authority records the portion of the District's payments that are attributable to principal payments on the Authority's debt as a reduction in the Authority's debt service receivable due from the District, a balance sheet item.

Debt service contributions decreased by \$0.8 million for the fiscal year 2012 from 2011 primarily due to the pay down on the 1998D Domestic Water Bonds. In 2011 the increase from 2010 was \$2.1 million.

Expenses

Interest expense decreased by \$1.0 million in the fiscal year 2012 from 2011 primarily due to the pay down on the 1998D Domestic Water Bonds. In 2011 the increase from 2010 was \$2.7 million.

MODESTO IRRIGATION DISTRICT FINANCING AUTHORITY
(A Component Unit of Modesto Irrigation District)

BALANCE SHEETS
As of December 31, 2012 and 2011

(Dollars in Thousands)

ASSETS AND DEFERRED OUTFLOWS	2012	2011
CURRENT ASSETS		
Cash and investments - restricted	\$ 3,606	\$ 1,293
Interest receivable	356	356
Current portion of debt service installment receivable	4,323	6,190
Total Current Assets	8,285	7,839
OTHER ASSETS		
Cash and investments - restricted	17,210	33,030
Interest receivable - restricted	187	202
Debt service installment receivable, less current portion	221,169	210,208
Total Other Assets	238,566	243,440
DEFERRED OUTFLOWS OF RESOURCES		
Deferred cash flow hedges - unrealized loss on derivatives	32,190	34,518
TOTAL ASSETS AND DEFERRED OUTFLOWS	\$ 279,041	\$ 285,797
LIABILITIES AND NET POSITION		
CURRENT LIABILITIES		
Current portion of long-term debt	\$ 4,175	\$ 3,980
Interest payable	3,753	3,820
Total Current Liabilities	7,928	7,800
NONCURRENT LIABILITIES		
Long-term debt, net of current portion	241,890	246,065
Unamortized premium	23	41
Unamortized debt discount	(1,296)	(1,380)
Unamortized loss on advance refunding	(1,730)	(2,076)
Arbitrage liability	36	829
Derivative financial instruments	32,190	34,518
Total Noncurrent Liabilities	271,113	277,997
TOTAL LIABILITIES AND NET POSITION	\$ 279,041	\$ 285,797

See accompanying notes to financial statements.

MODESTO IRRIGATION DISTRICT FINANCING AUTHORITY
(A Component Unit of Modesto Irrigation District)

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
For the Years Ended December 31, 2012 and 2011

(Dollars in Thousands)

	2012	2011
NON-OPERATING REVENUES		
Debt service contributions	\$ 10,628	\$ 11,445
Interest income	511	661
Other non-operating revenue	1,426	1,426
Total Non-Operating Revenues	12,565	13,532
NON-OPERATING EXPENSES		
Interest expense	12,152	13,104
Amortization of debt discount	84	80
Amortization of premium	(18)	(25)
Amortization of loss on refunding	347	373
Total Non-Operating Expenses	12,565	13,532
CHANGE IN NET POSITION	-	-
NET POSITION - Beginning of Year	-	-
NET POSITION - END OF YEAR	\$ -	\$ -

See accompanying notes to financial statements.

MODESTO IRRIGATION DISTRICT FINANCING AUTHORITY
(A Component Unit of Modesto Irrigation District)

STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2012 and 2011

(Dollars in Thousands)

	2012	2011
CASH FLOWS FROM NONCAPITAL AND RELATED FINANCING ACTIVITIES		
Principal payments on long-term debt	\$ (3,980)	\$ (3,790)
Interest paid	(12,220)	(13,168)
Debt service payments received from the District	16,199	16,958
Advances to the District for the construction of capital assets	(14,032)	(30,407)
Net Cash Flows Used in Noncapital and Related Financing Activities	(14,033)	(30,407)
 CASH FLOWS FROM INVESTING ACTIVITIES		
Investments purchased	(4,183)	(28,503)
Investments sold and matured	17,777	64,294
Interest received	526	738
Net Cash Flows Provided by Investing Activities	14,120	36,529
 Increase in Cash and Cash Equivalents	87	6,122
 CASH AND CASH EQUIVALENTS - Beginning of Year	8,541	2,419
 CASH AND CASH EQUIVALENTS - END OF YEAR	\$ 8,628	\$ 8,541
 RECONCILIATION OF CASH AND CASH EQUIVALENTS TO BALANCE SHEET ACCOUNTS		
Current assets - cash and investments - restricted	\$ 3,606	\$ 1,293
Other assets - cash and investments - restricted	17,210	33,030
Total Cash and Investments	20,816	34,323
Less: Noncash equivalents	12,188	25,782
 CASH AND CASH EQUIVALENTS	\$ 8,628	\$ 8,541
 SUPPLEMENTAL DISCLOSURE OF NONCASH ACTIVITIES		
Change in valuation of derivative financial instruments	\$ 2,328	\$ (17,808)

See accompanying notes to financial statements.

MODESTO IRRIGATION DISTRICT FINANCING AUTHORITY
(A Component Unit of Modesto Irrigation District)

NOTES TO FINANCIAL STATEMENTS
As of and For the Years Ended December 31, 2012 and 2011
(Dollars in Thousands)

NOTE 1 – ORGANIZATION AND DESCRIPTION OF BUSINESS

The Modesto Irrigation District Financing Authority (the “Authority”) was established in 1989 pursuant to a joint exercise of powers agreement between the Modesto Irrigation District (the “District”) and the City of Redding. The purpose of the Authority is to provide financing and contracting for capital improvements of the District. The District’s Board of Directors is designated to serve in the same capacity for the Authority. The Authority is a component unit of the District. The Authority is exempt from payment of federal and state income taxes.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the Authority have been prepared in conformity with accounting principles generally accepted in the United States of America. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

The significant accounting principles and policies utilized by the Authority are described below.

MEASUREMENT FOCUS, BASIS OF ACCOUNTING AND FINANCIAL STATEMENT PRESENTATION

The financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when the liability is incurred or economic asset used. Revenues, expenses, gains, losses, assets and liabilities resulting from exchange and exchange-like transactions are recognized when the exchange takes place. The Authority’s accounts are included as a component unit in the financial statements of the District.

In June 2011, the GASB issued Statement No. 63 - *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. This statement provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. Previous financial reporting standards did not include guidance for these elements, which are distinct from assets and liabilities. The Authority implemented this standard effective January 1, 2012.

Presentation 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 revenues and expenses during the reporting period. Actual results could differ from those estimates.

CONTRIBUTED SERVICES

The Assistant General Manager - Finance and the Controller of the District oversee the Authority’s administrative, management and accounting functions. Costs for these services are borne by the District and are not charged to the Authority.

MODESTO IRRIGATION DISTRICT FINANCING AUTHORITY
(A Component Unit of Modesto Irrigation District)

NOTES TO FINANCIAL STATEMENTS
As of and For the Years Ended December 31, 2012 and 2011
(Dollars in Thousands)

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

CASH AND CASH EQUIVALENTS

Cash equivalents include all money market funds and debt instruments with maturity dates of three months or less from the date of purchase.

INVESTMENTS

Generally, all investments are carried at their fair market value, except for guaranteed investment contracts (GICs), which are carried at cost. Market values may have changed significantly after year-end.

RESTRICTED ASSETS

Mandatory segregations of assets are presented as restricted assets. Such segregations are required by bond agreements and other external parties. All current liabilities listed are payable from these restricted assets.

DEBT SERVICE INSTALLMENT RECEIVABLE

The District and the Authority have Installment Purchase Contracts whereby the District is obligated to pay to the Authority installment payments equal to the debt service requirements of the Authority's long-term debt. The debt service installment receivable represents the amount due from the District to meet the Authority's debt service requirements, which includes principal and accrued interest. The noncurrent portion is equal to the noncurrent portion of long-term debt less cash held by the trustee for the 2007 and 2010 issues. The remaining balance is classified as current.

LONG-TERM DEBT

Long-term debt and other obligations are reported as liabilities. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the effective interest rate method. Gains or losses on prior refundings are amortized over the remaining life of the old debt or the life of the new debt, whichever is shorter.

ARBITRAGE LIABILITY

Interest earnings on tax exempt bond funds are subject to arbitrage rules of the Internal Revenue Service (IRS) if interest earnings on the unspent tax exempt funds are greater than the stated bond yield on the tax exempt debt. As of December 31, 2012 and 2011, the Authority has recorded a liability of \$36 and \$829, respectively, for a potential arbitrage rebate to the IRS. Arbitrage rebates are due five years from the issuance date of the tax exempt debt.

MODESTO IRRIGATION DISTRICT FINANCING AUTHORITY
(A Component Unit of Modesto Irrigation District)

NOTES TO FINANCIAL STATEMENTS
As of and For the Years Ended December 31, 2012 and 2011
(Dollars in Thousands)

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

CLASSIFICATION OF REVENUES AND EXPENSES

The Authority distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the Authority's principal ongoing operations. The Authority considers operating revenues and expenses in the statement of revenues and expenses and changes in net position to be those revenues and expenses that result from exchange transactions or other activities that are connected directly to the Authority's primary functions. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

EFFECT OF NEW ACCOUNTING STANDARDS ON CURRENT PERIOD FINANCIAL STATEMENTS

The GASB has approved GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*; Statement No. 66, *Technical Corrections - 2012 - an amendment of GASB Statements No. 10 and No. 62*; Statement No. 67, *Financial Reporting for Pension Plans - an amendment of GASB Statement No. 25*; and Statement No. 68, *Accounting and Financial Reporting for Pensions - an amendment of GASB Statement No. 27*. Application of these standards may restate portions of these financial statements.

NOTE 3 – CASH AND INVESTMENTS

The Authority's investment policies are governed by the California Government Codes and its bond Indenture, which restricts the Authority's investment securities to obligations which are unconditionally guaranteed by the United States (U.S.) Government or its agencies or instrumentalities; direct and general obligations of the State of California (State) or any local agency within the State; bankers' acceptances; commercial paper; certificates of deposit; time certificates of deposit; repurchase agreements; reverse repurchase agreements or securities lending agreements; medium-term corporate notes; shares of beneficial interest; mortgage pass-through securities; financial futures and financial option contracts; and deposits with the Local Agency Investment Fund (LAIF).

The Authority follows the District's investment policy. The District's investment policy includes restrictions for investments relating to maximum amounts invested as a percentage of total portfolio and with a single issuer, maximum maturities, and minimum credit ratings.

Deposits in each local and area bank are insured by the FDIC in the amount of \$250 for time and savings accounts (including NOW accounts), \$250 for interest-bearing demand deposit accounts, and unlimited for noninterest bearing transaction accounts through December 31, 2012. On January 1, 2013, the temporary unlimited coverage for noninterest bearing transaction accounts expired. Therefore, demand deposit amounts (interest-bearing and noninterest bearing) are insured for a total of \$250 beginning January 1, 2013. In addition, if deposits are held in an institution outside of the state in which the government is located, insured amounts are further limited to a total of \$250 for the combined amount of all deposit accounts.

MODESTO IRRIGATION DISTRICT FINANCING AUTHORITY
(A Component Unit of Modesto Irrigation District)

NOTES TO FINANCIAL STATEMENTS
As of and For the Years Ended December 31, 2012 and 2011
(Dollars in Thousands)

NOTE 3 – CASH AND INVESTMENTS (cont.)

CUSTODIAL CREDIT RISK

Deposits

Custodial credit risk is the risk that in the event of a financial institution failure, the Authority's deposits may not be returned to the Authority.

As of December 31, 2012 and 2011, \$0 and \$2,805 of the Authority's bank balances are known to be individually exposed to custodial credit risk, respectively.

The District's investment policy does not address this risk.

Investments

For an investment, 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 any investments exposed to custodial credit risk.

The District's investment policy addresses this risk. All securities owned by the District shall be held in safekeeping by a third party custodian, acting as agent for the District under the terms of a custody agreement.

CREDIT RISK

Credit risk is the risk an issuer or other counterparty to an investment will not fulfill its obligations.

As of December 31, 2012 and 2011, the Authority had the following investments that were not rated:

Investment Agreement Contracts
Money Market Mutual Funds

The District's investment policy addresses this risk. The District limits investments to those rated, at a minimum, "A" or equivalent for medium-term notes and "A-1" or equivalent for commercial paper by a nationally recognized rating agency.

MODESTO IRRIGATION DISTRICT FINANCING AUTHORITY
(A Component Unit of Modesto Irrigation District)

NOTES TO FINANCIAL STATEMENTS
As of and For the Years Ended December 31, 2012 and 2011
(Dollars in Thousands)

NOTE 3 – CASH AND INVESTMENTS (cont.)

CONCENTRATION OF CREDIT RISK

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer.

At December 31, 2012 and 2011, the Authority's investment portfolio was concentrated as follows:

Investment Type	Percentage of Portfolio	
	2012	2011
Guaranteed Investment Contracts:		
FSA Capital Management Services	65.71%	25.61%
NATIXIS Funding Corporation	34.29%	56.84%

The District's investment policy addresses this risk and places limits on the amounts invested in specific types of investments.

INTEREST RATE RISK

Interest rate risk is the risk changes in interest rates will adversely affect the fair value of an investment.

Though the District has restrictions as to the maturities of some of the investments, it does not have a formal policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increases in interest rates. As of December 31, 2012 and 2011, \$4,982 and \$5,486 of the Authority's total portfolio is subject to interest rate risk, respectively. The full balance has a maturity of one year or less.

MODESTO IRRIGATION DISTRICT FINANCING AUTHORITY
(A Component Unit of Modesto Irrigation District)

NOTES TO FINANCIAL STATEMENTS
As of and For the Years Ended December 31, 2012 and 2011
(Dollars in Thousands)

NOTE 4 – RESTRICTED ASSETS

RESTRICTED ACCOUNTS

Certain proceeds of the Authority's debt, as well as certain resources set aside for their repayment, are classified as restricted assets on the balance sheet because their use is limited. The following accounts are reported as restricted assets:

- Redemption - Used to segregate resources accumulated for debt service payments over the next twelve months.
- Reserve - Used to report resources set aside to make up potential future deficiencies in the redemption account.
- Project - Used to report debt proceeds restricted for use in construction.

	Carrying Value	
	December 31, 2012	December 31, 2011
Restricted Accounts		
Project Fund	\$ 5,010	\$ 19,232
Reserve Fund	12,200	13,798
Redemption Fund	<u>3,606</u>	<u>1,293</u>
Total Restricted Accounts	<u>\$ 20,816</u>	<u>\$ 34,323</u>

NOTE 5 – LONG-TERM DEBT

LONG-TERM DEBT

The following bonds have been issued:

Date	Issue	Final Maturity	Interest Rate	Original Amount	Outstanding Amount 12/31/12
2/26/98	1998D Domestic Water Bonds	9/1/22	4.75 – 5.50%	\$ 94,715	\$ 52,620
6/26/07	2007F Domestic Water Revenue Bonds	9/1/37	Index Rate	93,190	93,190
6/23/10	2010A Electric System Revenue BAB Bonds	10/1/40	4.78 – 7.20%	60,325	60,325
6/23/10	2010B Electric System Revenue Bonds	10/1/32	5.00%	39,930	39,930

MODESTO IRRIGATION DISTRICT FINANCING AUTHORITY
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NOTES TO FINANCIAL STATEMENTS
As of and For the Years Ended December 31, 2012 and 2011
(Dollars in Thousands)

NOTE 5 – LONG-TERM DEBT (cont.)

LONG-TERM DEBT (cont.)

The Domestic Water Revenue Bonds are collateralized by a pledge of payments made by the City of Modesto (the “City”) relating to the District’s water service to the City under the Amended and Restated Treatment and Delivery Agreement (ARTDA). The Authority also maintains a surety bond for the benefit of Domestic Water Bond Holders in an amount equal to the maximum annual debt service on the Bonds. The District provides wholesale urban water service to the City in connection with the ARTDA. The District supplies treated water from a domestic surface water treatment plant (Domestic Water Plant) to the City for use within its water system, and the City pays for all costs associated with the Domestic Water Plant. In accordance with provisions of the ARTDA, the costs paid by the City include the District’s debt service obligations on the debt issued to finance the construction and costs incurred by the District to operate the Domestic Water Plant.

The net revenue of the District’s electric system is pledged for repayment of the 2010 series A and B revenue bonds.

The Authority is in compliance with required bond covenants.

LONG-TERM DEBT REPAYMENT

Revenue bonds debt service requirements to maturity follows:

<u>Year Ending December 31,</u>	<u>Principal</u>	<u>Interest</u>	<u>Interest Rate Subsidy</u>	<u>Total</u>
2013	\$ 4,175	\$ 12,767	\$ (1,425)	\$ 15,517
2014	4,395	12,553	(1,425)	15,523
2015	4,615	12,328	(1,425)	15,518
2016	7,145	12,103	(1,425)	17,823
2017	7,455	11,751	(1,387)	17,819
2018-2022	42,585	52,772	(6,239)	89,118
2023-2027	39,675	42,739	(5,722)	76,692
2028-2032	50,065	32,596	(5,722)	76,939
2033-2037	66,965	18,616	(4,452)	81,129
2038-2040	18,990	2,778	(493)	21,275
Total Requirements	\$ 246,065	\$ 211,003	\$ (29,715)	\$ 427,353

Pursuant to the requirements of the Balanced Budget and Emergency Deficit Control Act of 1985, as amended, certain automatic reductions will be effective March 1, 2013 for qualified bonds including the District’s 2010A series Bonds. Federal subsidies for these bonds will be reduced by 8.7% through the end of the federal fiscal year (September 30, 2013) or convening U.S. Congressional action, at which time the sequestration rate is subject to change. The District estimates a reduction of 5.1% after September 30, 2013 on an annualized basis and is subject to change from U.S. Congressional action.

MODESTO IRRIGATION DISTRICT FINANCING AUTHORITY
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NOTES TO FINANCIAL STATEMENTS
As of and For the Years Ended December 31, 2012 and 2011
(Dollars in Thousands)

NOTE 5 – LONG-TERM DEBT (cont.)

FAIR VALUE

The estimated fair values of the Authority's long-term debt, calculated using the value of each individual series based on quoted market prices for the same or similar issues at December 31, 2012 and 2011, are as follows:

	<u>2012</u>	<u>2011</u>
Carrying amount	\$ 246,065	\$ 250,045
Fair value	240,544	226,818

LONG-TERM OBLIGATION SUMMARY

Long-term obligation activity for the year ended December 31, 2012 is as follows:

	<u>1/1/12</u>	<u>Additions</u>	<u>Reductions</u>	<u>12/31/12</u>	<u>Due Within</u>
	<u>Balance</u>			<u>Balance</u>	<u>One Year</u>
Domestic Water Revenue bonds	\$ 149,790	\$ -	\$ 3,980	\$ 145,810	\$ 4,175
Electric System Revenue bonds	100,255	-	-	100,255	-
Unamortized premium	41	-	18	23	-
Unamortized debt discount	(1,380)	-	(84)	(1,296)	-
Unamortized loss on advance refunding	(2,076)	-	(346)	(1,730)	-
Arbitrage liability	829	-	793	36	-
Derivative financial instruments	34,518	-	2,328	32,190	-
Totals	\$ 281,977	\$ -	\$ 6,689	\$ 275,288	\$ 4,175

Long-term obligation activity for the year ended December 31, 2011 is as follows:

	<u>1/1/11</u>	<u>Additions</u>	<u>Reductions</u>	<u>12/31/11</u>	<u>Due Within</u>
	<u>Balance</u>			<u>Balance</u>	<u>One Year</u>
Domestic Water Revenue bonds	\$ 153,580	\$ -	\$ 3,790	\$ 149,790	\$ 3,980
Electric System Revenue bonds	100,255	-	-	100,255	-
Unamortized premium	66	-	25	41	-
Unamortized debt discount	(1,460)	-	(80)	(1,380)	-
Unamortized loss on advance refunding	(2,449)	-	(373)	(2,076)	-
Arbitrage liability	829	-	-	829	-
Derivative financial instruments	16,710	17,808	-	34,518	-
Totals	\$ 267,531	\$ 17,808	\$ 3,362	\$ 281,977	\$ 3,980

MODESTO IRRIGATION DISTRICT FINANCING AUTHORITY
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NOTES TO FINANCIAL STATEMENTS
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NOTE 6 – DERIVATIVE INSTRUMENTS

SUMMARY OF NOTIONAL AMOUNTS AND FAIR VALUES

The Authority also enters into contracts to hedge its exposure to fluctuating interest rates. These contracts are evaluated pursuant to GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, to determine whether they meet the definition of derivative instruments, and, if so, whether they effectively hedge the expected cash flows associated with interest rate exposures.

The Authority applies hedge accounting for derivatives that are deemed effective hedges. Under hedge accounting, the increase (decrease) in the fair value of a hedge is reported as a deferred cash flow hedge – unrealized gain (loss) on derivatives on the balance sheet. For the reporting period, all of the Authority's derivatives meet the effectiveness tests.

For interest rate derivatives, the Authority subscribes to a financial information service that it uses to verify fair value estimates obtained from its counterparties.

The following is a summary of the fair values and notional amounts of derivative instruments outstanding as of December 31, 2012 (amounts in thousands; gains shown as positive amounts, losses as negative).

<u>2012 Change in Fair Value</u>		<u>Fair Value, End of 2012</u>		<u>Notional</u>
<u>Classification</u>	<u>Amount</u>	<u>Classification</u>	<u>Amount</u>	<u>(Thousands)</u>

Effective Cash Flow Hedges

Interest Rate Derivatives:

Pay-fixed swaps, interest rate	Deferred Inflow	\$	2,328	Derivative	\$	(32,190)	\$	93,190
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The following is a summary of the fair values and notional amounts of derivative instruments outstanding as of December 31, 2011 (amounts in thousands; gains shown as positive amounts, losses as negative).

<u>2011 Change in Fair Value</u>		<u>Fair Value, End of 2011</u>		<u>Notional</u>
<u>Classification</u>	<u>Amount</u>	<u>Classification</u>	<u>Amount</u>	<u>(Thousands)</u>

Effective Cash Flow Hedges

Interest Rate Derivatives:

Pay-fixed swaps, interest rate	Deferred Outflow	\$	(17,808)	Derivative	\$	(34,518)	\$	93,190
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MODESTO IRRIGATION DISTRICT FINANCING AUTHORITY
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NOTE 6 – DERIVATIVE INSTRUMENTS (cont.)

OBJECTIVE AND TERMS OF HEDGING DERIVATIVE INSTRUMENTS

The objectives and terms of the Authority’s hedging derivative instrument that was outstanding at December 31, 2012 and 2011 is summarized in the next table. The table is aggregated by the credit ratings (using the Standard & Poor’s scale) of the District’s counterparties. For counterparties having multiple ratings, the rating indicating the greatest degree of risk is used.

The interest rate swaps are designed to synthetically fix the cash flows associated with variable rate bonds. The interest rate that the Authority pays on the 2007F bonds is 67% of LIBOR plus a spread. With the interest rate swaps, the Authority pays the counterparty a fixed rate and receives 67% of LIBOR. Netting out the LIBOR-based payments, the Authority’s effective interest rate is the sum of the fixed rate paid to the swap counterparty and the spread.

Type	Objective	Notional (Thousands)	Effective Date	Maturity Date	Terms	Counterpart y Rating
Pay-fixed swaps, interest rate	Hedge cash flows on the 2007F bonds	\$ 93,190	Jun-07	Sep-37	Pay 4.378-4.440%; Receive 67% of LIBOR	A

RISKS OF DERIVATIVE INSTRUMENTS

Credit risk – Credit risk is the risk of loss due to a counterparty defaulting on its obligations. The Authority seeks to minimize credit risk by transacting with creditworthy counterparties. Interest rate swap counterparties are evaluated at the time of transaction execution.

Termination risk – Termination risk is the risk that a derivative will terminate prior to its scheduled maturity due to a contractual event. Contractual events include bankruptcy, illegality, default, and mergers in which the successor entity does not meet credit criteria. One aspect of termination risk is that the Authority would lose the hedging benefit of a derivative that becomes subject to a termination event. Another aspect of termination risk is that, if at the time of termination the mark-to-market value of the derivative was a liability to the Authority, the Authority could be required to pay that amount to the counterparty. Termination risk is associated with the Authority’s derivative up to the fair value amount.

HEDGED DEBT

Net cash flows for the Authority’s synthetic fixed-rate debt are shown below. These amounts assume that the interest rates of the bonds and the reference rates of the hedging derivative instruments remain at December 31, 2012 levels. These rates will vary and, as they do, interest payments on the variable-rate bonds and net receipts/payments on the interest rate swaps will vary. The table shows only the Authority’s effectively hedged synthetic fixed-rate debt, which is a subset of the Authority’s total debt. As of December 31, 2012, all of the Authority’s variable-rate debt is effectively hedged.

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NOTE 6 – DERIVATIVE INSTRUMENTS (cont.)

RISKS OF DERIVATIVE INSTRUMENTS (cont.)

Year Ending December 31	Principal	Interest	Net Payment on Derivatives	Total
2013	\$ -	\$ 766	\$ 3,357	\$ 4,123
2014	-	766	3,357	4,123
2015	-	766	3,357	4,123
2016	-	766	3,357	4,123
2017	-	766	3,357	4,123
2018-2022	-	3,832	16,783	20,615
2023-2027	23,370	3,436	14,969	41,775
2028-2032	29,250	2,388	10,308	41,946
2033-2037	40,570	1,024	4,419	46,013
	<u>40,570</u>	<u>1,024</u>	<u>4,419</u>	<u>46,013</u>
Totals	<u>\$ 93,190</u>	<u>\$ 14,510</u>	<u>\$ 63,264</u>	<u>\$ 170,964</u>