

Memo

From: Zane Miller, General Manager

To: 1-A Board of Directors
1-B Board of Directors
1-C Board of Directors
1-D Board of Directors
1-E Board of Directors
1-F Board of Directors
1-G Board of Directors
1-H Board of Directors

Date: August 7, 2008

RE: Preliminary FY 2008/09 Combined Budget

Introduction

This budget process (FY 08/09) marks the first attempt to separate revenues and expenses into different funds and individual departments within the annual budget. The ultimate purpose *in* this refined budget is to create a better tool that can be used to accurately monitor performance by expense, revenue or department. Separating and refining the budget is an extensive process that will take several budget cycles to completely refine. While I feel that we have created a solid base-line budget to begin this modification process, there will be issues that have not been contemplated resulting in further adjustments in the current and future years.

Each Board is receiving a preliminary budget manual which includes this memo, a District specific Addendum, the preliminary budget and supporting back-up materials for reference.

Overview of Budget Process

The budget or FOMB (Facilities Operating and Maintenance Budget) is divided into four basic categories which translate into expenditure allocations of each District for the purpose of

setting rates, fee's and tax assessments. The categories are direct, personnel/overhead, M&O connections and usage. Direct and usage expenses are actual expenditures allocated to a specific District for items such as Director expenses, legal fees, auditing services and water usage. Personnel/overhead expenses are those administrative expenses which are allocated based on staff time spent as determined by the General Manager.

M&O connection expenses over the past few budget cycles have been an allocation of the number of water meters in a single District as a percentage of the total water meters in all Districts. While this process has worked in the past when most residential meters were one inch, the addition of smaller residential meters and larger commercial meters skews the overall balance between Districts. Staff researched the option of converting the allocation methodology from a 1:1 ratio to a Living Unit Equivalent (LUE) factor based on meter size but found that it did not take a significant percentage expense load off the primarily residential Districts.

The best long term option for a M&O percentage allocation is by basing the percentage on the anticipated assessed property value of each District as compared to the anticipated total value of all Districts. By utilizing an anticipated value based system of allocating M&O expenses, the overall burden is shifted to the commercial Districts much quicker, placing the expense load on the properties that have the highest potential of generating significant property tax revenue as well as sales tax revenues, which is not available to District 1-B or 1-E.

Forecasted values are derived by taking the current year taxable value plus the forecasted development in FY 08/09, which is the January 1, 2010 taxable value. Existing values are increased 2% annually which is a conservative annual DCAD appraisal increase. New residential values are estimated by modeling items such as available lots, average home values, average home sizes and lot take-down schedules of the developer. The same general approach is used to estimate commercial construction and values. The charts below model the anticipated assessed values of each District through 2020 and the change in the percentage allocation based on the forecasted assessed value method.

Forecasted Values

Budget Year	1A	1B	1C	1D
2008/09	\$ 200,000	\$ 275,810,388	\$ 6,287,517	\$ 352,801,693
2009	\$ 204,000	\$ 284,411,778	\$ 6,413,267	\$ 371,355,182
2010	\$ 208,080	\$ 292,498,940	\$ 6,541,532	\$ 390,279,741
2011	\$ 212,242	\$ 300,697,892	\$ 6,672,363	\$ 409,582,791
2012	\$ 216,486	\$ 308,674,444	\$ 6,805,810	\$ 423,523,175
2013	\$ 220,816	\$ 316,964,801	\$ 6,941,926	\$ 437,742,366
2014	\$ 225,232	\$ 325,538,797	\$ 7,080,765	\$ 446,497,214
2015	\$ 229,737	\$ 334,366,250	\$ 7,222,380	\$ 455,427,158
2016	\$ 234,332	\$ 343,356,646	\$ 7,366,828	\$ 464,535,701
2017	\$ 239,019	\$ 352,619,768	\$ 7,514,164	\$ 473,826,415
2018	\$ 243,799	\$ 362,143,389	\$ 7,664,448	\$ 483,302,943
2019	\$ 248,675	\$ 371,920,412	\$ 7,817,737	\$ 492,969,002
2020	\$ 253,648	\$ 381,950,348	\$ 7,974,091	\$ 502,828,382

Forecasted Values

Budget Year	1E	1F	1G	1H
2008	\$ 270,768,602	\$ 222,725,467	\$ 84,131,784	\$ 148,911,011
2009	\$ 285,403,341	\$ 341,093,876	\$ 185,784,620	\$ 210,539,231
2010	\$ 297,063,775	\$ 461,141,454	\$ 361,997,912	\$ 312,526,016
2011	\$ 308,957,418	\$ 554,909,983	\$ 541,735,470	\$ 449,875,936
2012	\$ 318,112,750	\$ 625,561,332	\$ 683,576,880	\$ 605,654,455
2013	\$ 327,451,189	\$ 666,752,559	\$ 697,248,417	\$ 746,906,744
2014	\$ 334,000,212	\$ 694,427,610	\$ 711,193,386	\$ 857,738,679
2015	\$ 340,680,217	\$ 722,656,162	\$ 725,417,253	\$ 939,424,052
2016	\$ 347,493,821	\$ 737,109,286	\$ 739,925,598	\$ 958,212,533
2017	\$ 354,443,697	\$ 751,851,471	\$ 754,724,110	\$ 977,376,784
2018	\$ 361,532,571	\$ 766,888,501	\$ 769,818,593	\$ 996,924,320
2019	\$ 368,763,223	\$ 782,226,271	\$ 785,214,964	\$ 1,016,862,806
2020	\$ 376,138,487	\$ 797,870,796	\$ 800,919,264	\$ 1,037,200,062

Forecasted Allocation Percentages

Year	1A	1B	1C	1D	1E	1F	1G	1H
2008	0.02%	20.26%	0.46%	25.91%	19.89%	16.36%	6.18%	10.94%
2009	0.01%	16.88%	0.38%	22.04%	16.94%	20.24%	11.02%	12.49%
2010	0.01%	13.78%	0.31%	18.39%	14.00%	21.73%	17.06%	14.73%
2011	0.01%	11.69%	0.26%	15.92%	12.01%	21.57%	21.06%	17.49%
2012	0.01%	10.39%	0.23%	14.25%	10.70%	21.05%	23.00%	20.38%
2013	0.01%	9.90%	0.22%	13.68%	10.23%	20.83%	21.79%	23.34%
2014	0.01%	9.64%	0.21%	13.22%	9.89%	20.57%	21.06%	25.40%
2015	0.01%	9.48%	0.20%	12.92%	9.66%	20.50%	20.58%	26.65%
2016	0.01%	9.54%	0.20%	12.91%	9.66%	20.49%	20.56%	26.63%
2017	0.01%	9.60%	0.20%	12.90%	9.65%	20.47%	20.55%	26.61%
2018	0.01%	9.66%	0.20%	12.89%	9.64%	20.46%	20.54%	26.60%
2019	0.01%	9.72%	0.20%	12.88%	9.64%	20.44%	20.52%	26.58%
2020	0.01%	9.78%	0.20%	12.88%	9.63%	20.43%	20.51%	26.56%

This new methodology will require a modification to the existing Operating Agreement that 1-A has with each District.

The most difficult task in any municipal budgeting process is forecasting the growth that will be experienced in future years and anticipating revenues and expenditures that development causes. Each District must be forecasted individually anticipating changes in market conditions, climate changes and unknown events which can alter development plans seemingly overnight. A comprehensive development forecast has been developed to provide a “guide” for developing budgets, although, it is only a guide as the Districts do not develop individual properties and have no control of this ultimate process. That being said, I have a high level of confidence in the FY 08/09 forecasting of the residential, multi-family and commercial properties that will be brought into the Districts. (Tab 3)

The Operating Agreement that 1-A has with each District sets forth the basic budgeting process and methods utilized. Section 2.2 of the Operating Agreement specifies that 1-A shall be responsible for preparing and submitting to each District for approval the annual FOMB. Each District has the ability to review and make suggestions to the 1-A Board regarding the FOMB. However, “ with the exception of expenses based on Customer usage, if the total actual

expenses incurred on behalf of ...(each District) during the fiscal year do not exceed the estimated FOMB for that fiscal year by more than 12%, all suggestions by(each District) for revision of the next year fiscal year’s FOMB shall be deemed advisory only, and(each District) shall be obligated to make the payments to District 1-A set forth in the next year’s proposed FOMB for the operation of District Facilities.”

The chart below lists the expected percentage of expenses to the adopted budget. With the exception of District 1-C, all are below the 12% cap. (Tab 4)

District	Budget	Estimated	Budget Estimate
1-A	\$ 203,181	\$ 204,482	101%
1-B	\$ 1,591,707	\$ 1,639,395	102%
1-C	\$ 32,504	\$ 51,267	158%
1-D	\$ 1,406,288	\$ 1,465,709	104%
1-E	\$ 1,294,749	\$ 1,344,761	104%
1-F	\$ 979,982	\$ 965,988	99%

Any comments on the FOMB shall be delivered to District 1-A within 30 days after receipt by each District of the proposed FOMB. A preliminary FOMB will be presented to each District in July for review purposes. During the August board meetings, action will be taken by the 1-A Board to adopt the budget with any changes which are required to meet Certified Tax Rolls projections, modifications to expense categories which will be finalized after the preliminary budget delivery and/or other items which need to be corrected. Also, during the August meeting, each District board will be required to adopt a resolution calling a public hearing on setting the tax rate and adoption of the final FOMB in September. At the September meeting, final action will be taken by the 1-A Board to adopt the FOMB and by all other Boards adopting their tax rates and Rate Order which generates the revenue structure to make the revenue projections presented by 1-A in the FOMB.

If an individual board is not in favor of the proposed tax rate, other revenue modifications for that District must be presented to the 1-A Board which provides a revenue structure to offset any decrease in property taxes.

Overall Budgeting Structure

Past budgets have been defined at two basic levels; revenues and expenditures. While this process has been simple to administer and monitor it does not provide an accurate history of the amount collected or spent on each basic individual function or activity. This prohibits us the ability to track items such as sewer expenses compared to residential unit growth. At some point basic expenses level out with growth as economies of scale are reached. However, with our current budgeting process it is difficult at best to determine those calculations.

You will see in the budgeting process that I have divided all expense categories into seven new departments: Permits/Inspections, Parks, Drainage, Streets, Water, Sewer and Administration. Each department going forward will be responsible for accuracy in budgeting, expenses and revenues. This process places ownership on the supervisory staff of each of these functions for accuracy and accountability for the budgeting process throughout the fiscal year. The departmental budgeting process also allows us to track specific efficiencies or cost items in proportion to growth which provides leadership with better forecasting tools in future years. As each of the Districts continue to grow and age, additional staff will be required to manage the extensive infrastructure systems that have been installed with dedicated staff assigned to a group of individual functions. It is very difficult at this point with our current budget structure to develop models which forecast these needs.

The proposed budget is further divided into a fund based system. There are two primary reasons for this transition. First, is the ability to allocate expenditures based on revenue source. The largest challenge to this process is making each fund “stand alone” and generate surplus balances in each fund to be uses as reserves. Districts will be required to do a fund transfer from revenues to balance each fund so that they operate in a cash positive basis. The second reason for this shift in accounting is to begin to lay the groundwork for each District to have a

clear revenue source that can be utilized to repay developer advance obligations. Developer advance obligations can be repaid through revenue streams other than property tax revenue. The creation of different funds begins the process of separating expenses and revenues to accurately account for surplus revenues so these District obligations can be eliminated in the future.

Revenue

In the fund based system each revenue stream is allocated to either general fund revenue, utility fund revenue or debt fund revenue. General fund revenues in the budget are derived solely from the M&O portion of the property tax as it becomes available in each individual District. Utility fund revenues are comprised from all other revenue streams; water sales, sewer sales, permits, fines, etc. Tax fund revenue is from the I&S portion of the property tax assessments.

Revenue in the FOMB is credited to each District which generates the revenues when it is clearly identifiable (i.e. building permits). In cases when revenue sources are not clearly identifiable, such as contractor registration, they are divided equally based on the M&O expense allocation model, equal percentage, or other method. Revenue calculations are generated from forecasted development, the existing Rate Order and M&O tax collections. The Operating Agreement specifies that each District shall generate a revenue stream capable of paying all District expenses.

Water sales are forecasted on both winter and summer averages to provide revenue based on a "typical" year. FY 06/07 experienced a wet year and reduced water revenue. Thus far in FY 07/08 a more typical hot summer has generated more "typical" water sales. Water revenue is based on a 3 year average, taking into account high's and low's in water usage. The water rate structure that was put into place in November, 2007, was an attempt to curtail excessive watering through an increased tier system. This system does not appear to slow down usage, however, it is generating increased revenues. Large commercial property usage in the District is still an unknown for consumption and billing. Basic averages have been utilized this fiscal year for commercial property until trends are developed.

Upper Trinity has increased potable water volume rates \$.09 per 1,000 gallons purchased from \$.77 to \$.86. This rate increase should be passed to our customers with a modification to the Rate Order to prevent larger increases in future years. This adjustment translates to an annual customer increase of \$16.51 or 2.69% annual increase. In addition to the Upper Trinity increase, Waste Management is increasing solid waste rates 4% (2% contract increase and 2% fuel surcharge) which reflects a \$.56 monthly customer increase.

Water sales are projected to increase 64% in FY 08/09 primarily due to the philosophical shift on our accounting of public space irrigation. Historically, water usage for District property irrigation has not been billed based on the tier retail rate. Public irrigation has been paid by each District as a portion of the total Upper Trinity potable water costs, at the wholesale rate. However, in an attempt to better account for our public irrigation water usage from year to year, as we do with our private property owners, the park budget will include irrigation expenses at the retail tier rate, treating ourselves as another retail customer. While there is an additional expense to each District, revenue in each District has also increased proportionately to reflect the public irrigation water sales, off-setting the net gain.

Residential permit revenue is estimated to decrease this fiscal year 26%. This is due to a forecasted 211 new home starts in FY 08/09, as compared to 254 in this fiscal year. Single-family permits are expected to increase in FY 09/10, level-off for 2-3 years and begin to decline each year as build-out is reached around 2015. Commercial permit revenue is estimated to increase 73% with the addition of the multi-family and other expected commercial properties. Commercial permit sales is just now increasing and will do so for 3-5 years, then begin to level-out then decline until build-out is reached around 2018.

Property tax revenue continues to be a large portion of our combined budget, making up 31% of the total GF revenue. The proposed FOMB indicates a 45% reduction in property tax which is due to the 1-F property tax in FY 07/08 being allocated to M&O as PID 4 had no debt payment obligations this fiscal year.

Sales tax as part of the Strategic Partnership Agreement with Lewisville has not been projected as a revenue stream into this budget. Until agreements are finalized and sales tax receipts are actually realized, it is not advisable to count on this revenue stream. I will propose in future budgets that the District does not budget for a future year any more than actual estimated receipts of the current or prior year. This keeps the District away from budgeting a revenue stream that is highly volatile in the market place.

Expenses

Expenses in the new budget are divided into the same three basic categories; General Fund, Utility Fund and Debt Fund. All departmental expenses, except the water department, have been allocated to the General Fund. Since the revenue stream of the General Fund is limited to M&O property taxes, General Fund expenses will exceed General Fund revenues. The Utility Fund will supplement the General Fund through a fund transfer, with the goal of having a zero balance of each District in the General Fund each year. Board directors should keep in mind that unlike private business, each department in a governmental unit does not break even with revenues and expenses. For example, a street department does not have a revenue source so it is dependant on other revenue streams to be funded.

The District is not currently staffed at a level that has dedicated staff in each of the departments, so percentage allocations have been used this year to begin the initial budgeting process. As the Districts grow it may have staffing levels which demand specialized operations personnel by each of the departments. Until that staffing level occurs, percentage time allocation will be utilized.

Each fund and departmental budget is broken into four categories; Direct (specific charges for a District), Personnel/Overhead (charges allocated by time spent as determined by the General Manager), M&O (charges allocated by percentage of water meters), and Usage (customer usage charges). The Operating Agreement is specific on the method of allocation of expense items within the budget to time spent or connections. In an attempt to more accurately allocate

expenses to the correct District, department time spent allocations vary between some departments due to the forecasted work to be performed in the budgeted year. While this process is not an exact science and I have little actual histories to work from, the proposed FOMB makes a reasonable effort to allocate expense to the actual District where the work is performed.

There are a few significant expenditure changes that need to be noted, beyond expected "growth" related increases. Direct expenses have doubled from the current fiscal year to FY 08/09. This is primarily due to the 1-F property assessment of \$308K and the inclusion of District 1-H in the budgeting process. Direct expenses are not shared by allocation and are true and actual expenses for a specific District.

Personnel/Overhead costs have increased this fiscal year by 33% from FY 07/08. When comparing the proposed budget to the FY 07/08 budget, you will find new categories that have historically been an expense to the M&O portion of the budget and the addition of Districts 1-G and 1-H. Items highlighted in yellow are split 50% between personnel/overhead and M&O costs. Items such as lease equipment include everything from heavy equipment to office copiers. The split was done to accurately allocate costs to the appropriate portion of the budget. These items will have the highest possibility of modification throughout the year to ensure that individual expense line items are accurate in relation to the overall budget. Personnel/Overhead costs are allocated to each District based on time spent by staff as determined by the General Manager. Rather than assigning a percentage to the overall, combined expenses, each department has a personnel/overhead percentage assigned which accounts for type of department, age of District and work expected in the future year. This is not an exact science but I have attempted to apply fair, reasonable percentages to each District to cover anticipated expenses.

Increases attributed to personnel costs are discussed later in this memo. Gas and fuel is budgeted to increase by 28% overall to account for increased equipment and market rates.

The District offices will be moving into much needed larger lease space in the Village Shops in August of 2008. Due to the nature of the building, office rental expenses have increases by 212%. While this expense seems high, the District offices will be doubling in size to accommodate existing and future staff growth. Some current office expenses will be eliminated in the FY 08/09 budget, such as electric, janitorial services, window cleaning, ect., since they are included in the overall rental.

M&O expenses are those which are allocated based on the methodology adopted in the Operating Agreement. As discussed earlier in this memo, a modification is being proposed to change the methodology from water meters to anticipated valuation. Also included in the M&O category is the addition of Districts 1-G and 1-H. Overall the M&O portion of the budget has increased 36%, from \$3.235M to \$4.389M.

Potable water costs have increased by 136%, primarily due to the inclusion of public space irrigation. Water will also be purchased from the City of Lewisville this fiscal year and is a new potable water and demand fee not experienced in past years. Postage is becoming a significant portion of our expenses as development continues generating additional water billing demands. The maintenance portions of the budget for water, sewer and streets/drainage was held basically flat from the current budget. These items we can expect to grow significantly as each phase of development ages, requiring additional repairs and work.

Property Taxes

Property tax revenue is separated into two categories. Interest and sinking fund (I&S) is used for PID bond debt related expenses and is the largest portion of most Districts tax rate and is placed in the Debt Fund. Maintenance and Operations (M&O) is the second component of property taxes and is placed in the General Fund. The minimum tax rate requirement of each District is set to cover the I&S portion (bond debt) assuming a 95% collection rate on the total assessed value of each District. While each District is authorized to set an unlimited tax rate, there has been a position established to not set a rate that exceeds \$1.00 of assessed value,

although that is not a requirement. Once values of a particular District realizes development, which translates into increased assessed values, any “gap” between the required I&S rate and the combined rate would be the M&O portion of the combined rate for operational expenses.

FY 08/09 Proposed Tax Rate

	I&S Rate	M&O Rate	Combined
1-B	\$.6182	\$.2818	\$.90
1-C	\$.00	\$.90	\$.90
1-D	\$.8307	\$.0693	\$.90
1-E	\$.8915	\$.0085	\$.90
1-F	\$ 1.00	\$.00	\$ 1.00

Tax Impact

	2008 Assessed Value (100% collection rate)	1 Cent Equals	2007 Assessed Value	Difference
1-B	\$267,660,028	\$26,766	\$262,991,622	\$4,668,406
1-C	\$6,164,232	\$616	\$7,708,544	(\$1,544,312)
1-D	\$299,256,202	\$29,926	\$29,925	\$57,102,219
1-E	\$244,749,510	\$24,475	\$196,390,292	\$48,359,218
1-F	\$110,681,683	\$11,068	\$88,394,059	\$22,287,624

The adopted tax rate for Districts 1-B, 1-C, 1-D and 1-E for FY 07/08 is \$.90 per \$100 of valuation, while District 1-F is \$1.00 per \$100 of valuation. While it is the ultimate goal to lower property taxes each year, the underlying responsibility is to fund debt obligations and the operational functions, which can prevent a rate reduction each year. Each District has an outstanding obligation to the developer which needs to be planned for when considering lower tax rates. Keeping the tax rate level with last year, \$.90, begins to lay the foundation for developing a plan to make payment to the developer, develop contingency reserves with the ability to develop District specific capital improvement funds for specific repairs.

Personnel Summary

As with any budget, personnel costs remains one of the largest groups of expenses in the budget accounting for 18% of total operational expenses. Overall, the District has maintained a very low staff to population ratio for the services provided. Assuming that each household has

a population 3.5 persons, the District over the past 8 years has never had a staff ratio over 7/1,000 and last year was the lowest ever at 2.95/1,000.

Fiscal Year Ending	Employee per 1,000 population
2000	6.53
2001	6.03
2002	5.96
2003	5.96
2004	4.84
2005	5.29
2006	3.17
2007	3.00
2008	2.95
2009	4.04

Personnel costs are increasing substantially this fiscal year due to the addition of 7 new full time personnel. Four positions, or 1 crew, are being added in the maintenance department and 3 office support positions will be created.

The District will be instituting a new retirement program through the Texas County and District Retirement System. While the annual costs to the District is a significant increase over past retirement contributions, the program is needed to provide a benefits program that retains and attracts quality employees. Currently, the District has provided an optional 5% matching contribution to a 457 (b) deferred compensation account through AIG/Valic. Most municipal organizations in Texas are members of the Texas Municipal Retirement System (TMRS) and county agencies are member of the Texas County and District Retirement System (TCDRS), which work basically the same. Governmental agencies are allowed to opt out of the federal social security system if they participate in an authorized state run program. TCDRS provides a long term retirement program for our employees, comparable to most municipal programs, which in the past has been a hindrance to attracting and retaining quality employees at all levels of the organization. While this program does increase the retirement contribution significantly, social security will not longer be a budgeted expense which reduces the annual personnel cost impact.

Other Budget Items

Operating Agreement

Each Board will be submitted at the August board meetings an Amended and restated Operating Agreement which changes the budget methodology from meter connections to forecasted assessed value. In addition to the allocation methodology, the revised Operating Agreement has removed the earlier revisions which address the pooled cash accounting process. Under the advisement of our new legal firm, Section 2.6 should be removed to any reference to sharing of revenues between each District not contemplated within the FOMB.

Rate Order

Each year in the budgeting process an analysis of the Rate Order will be completed to ensure that the District is charging appropriate rates for services. Changes being proposed are generally clean-up in nature from the amendment done in November, 2007. New additions include a plan review fee for Engineering Site Plans and Grading Plans. This fee mirrors the Lewisville fee and covers staff review time and expenses of the extensive plan review process that commercial properties require. Each water tier rate should increase by \$.09 to cover increases being charged by Upper Trinity.

Residential solid waste monthly rates should be increased to \$14.69 at a minimum. Waste Management has indicated that the surcharge next fiscal year will most likely increase at a much larger rate than this year. Rates could be increased more this year to reduce a larger increase next year in our rate structure.

In November, 2007, the District increased the late fee from 5% to \$35 to reduce the delinquent accounts each month. At that time, we had over 20% delinquent accounts each month, many of which were habitually late. With the increased late fee the percentage has dropped to less than 10% each month, accomplishing our overall goal of on-time payments. I am recommending that we reduce our late fee to 10% in the Rate Order.