CAPITALIZATION POLICY (VER 1.0)

What is it? *"Capitalization" refers to the entity's authorization to fund its capital projects with various sources of debt, member contributions, cash reserves, or other sources (e.g. certificates of participation, leases, etc.).*

How it Fits in the Regional Plan? *The guiding principles state that the entity will own the future water production capacity assets for the region. The question of capitalization is about whether the entity should have the authority to finance those purchases by issuing its own debt and/or taking on its own obligations. In other words: should the entity (its board) be able to independently finance its capital needs?*

A PROPOSED STARTING POINT FOR DISCUSSIONS:

A key decision the CIRWG must make is whether the regional entity acts as a contributory organization, an enterprise organization, or something in-between. The difference between a contributory and enterprise organization is in the entity's authority to independently finance projects.

Contributory Organization

The funding of capital projects is dependent on the financial capacity and authorization of individual members. As capital projects are identified (by the regional entity) members raise the necessary funds based on some proportional allocation and contribute them to the regional entity for payment of project costs.

Enterprise Organization

The regional entity becomes its own enterprise and assumes responsibility for the financing of capital projects independently. Members may still directly contribute to fund capital projects but it is not the only means available to the entity. Financing can also include issuance of revenue bonds or other securities backed by the entity's assets and revenues. Enterprise organizations generally maintain their own financial statements and are typically not subcomponents of other governmental agencies. This means that the debts (and assets) of the regional entity would be recorded on its own balance sheet rather than that of the individual members.

The below table summarizes key features of both options. While not an exhaustive list, the table helps set a framework of relative pros and cons of each organization.

FEATURES	CONTRIBUTORY ORGANIZATION	ENTERPRISE ORGANIZATION
Issues its own revenue bonds or other securities?	No	Yes
Maintains its own cash and investment accounts?	No	Yes
Administrative requirements	Lower	Higher

FEATURES	CONTRIBUTORY ORGANIZATION	ENTERPRISE ORGANIZATION
Staffing needs	Lower	Higher
Expected organizational costs	Lower	Higher
Degree of financial independence	Lower	Higher
Speed in funding projects	Slower	Faster
Project funding risks	Greater	Lower
Funding complexity	More	Less
Liabilities reported by	Members	Entity
Assets reported by	Members	Entity

THINGS TO CONSIDER:

A primary remit for the proposed regional entity is planning and acquiring new water production capacity for the members. The group should consider how a contributory or enterprise structure best enables the regional entity to fulfill its obligations at the appropriate amount of authority. There are pros and cons with both of the above forms. One of the examples to look at regionally is that of the WRA. It started as what we've called a contributory organization using a 28E intergovernmental agreement. It later reorganized under a 28F agreement able to take on its own liabilities (i.e. debt) on its own balance sheet (an enterprise organization). Some of the group may have experience with the WRA example and can discuss the pros and cons from your perspectives. Legal counsel can provide more details on the differences between 28E and 28F. The 28F agreement would appear to be the correct form of agreement if the group decides to grant the entity authority to issue revenue bonds.

It is appropriate to consider the alignment between the obligation to serve, the governance structure, and the capitalization policy. If the idea is to create an entity with a strong obligation of service with regional decision making vested in the entity's board, then an enterprise-type organization is probably the better fit. A contributory-type organization may be a better fit if the idea is to gain stronger consensus for regional investments beyond the entity's own board. Contributory organizations tend to grant individual members "power of the pocketbook" making each individual member capable of delaying or stopping entire projects (by not funding them). In this case, the obligation of service would only be met when both the entity's board, and the members' boards are fully aligned. In general: an enterprise organization would increase the independence of the proposed entity while a contributory organizational structure would make the entity more dependent on individual members.