

OFFICIAL STATEMENT
Dated April 4, 2017

Rating: Insured Uninsured
Moody's: N/A "A2"
S&P: "AA" N/A
See ("OTHER INFORMATION – Ratings",
"BOND INSURANCE", and "BOND INSURANCE
GENERAL RISKS" herein)

NEW ISSUE - Book-Entry-Only

In the opinion of Andrews Kurth Kenyon LLP, Bond Counsel, assuming continuing compliance by the Authority (defined below) after the date hereof with certain covenants contained in the Indenture (defined below) and subject to the matters described herein, (i) interest on the Bonds (defined below) under existing statutes, regulations, published rulings and court decisions (1) will be excludable from the gross income of the owners thereof for federal income tax purposes under section 103 of the Internal Revenue Code of 1986, as amended and (2) will not be included in computing the alternative minimum taxable income of individuals or, except as described herein, corporations (see "TAX MATTERS" herein).

The Authority has designated the Bonds as "Qualified Tax-Exempt Obligations" for Financial Institutions.

\$9,255,000
SOUTHMOST REGIONAL WATER AUTHORITY
WATER SUPPLY CONTRACT REVENUE REFUNDING BONDS, SERIES 2017
(DESALINATION PLANT PROJECT)

Dated Date: April 1, 2017

Due: September 1, as shown on inside cover

Interest to accrue from Delivery Date

PAYMENT TERMS . . . Interest on the \$9,255,000 Southmost Regional Water Authority Water Supply Contract Revenue Refunding Bonds, Series 2017 (Desalination Plant Project) (the "Bonds") will accrue from the Delivery Date (as defined below), will be payable on March 1 and September 1 of each year commencing September 1, 2017 until stated maturity or prior redemption, and will be calculated on the basis of a 360-day year consisting of twelve 30-day months. The definitive Bonds will be initially registered and delivered only to Cede & Co., the nominee of The Depository Trust Company ("DTC") pursuant to the Book-Entry-Only System described herein. Beneficial ownership of the Bonds may be acquired in denominations of \$5,000 or integral multiples thereof. **No physical delivery of the Bonds will be made to the beneficial owners thereof.** Principal of, premium, if any, and interest on the Bonds will be payable by the Trustee to Cede & Co., which will make distribution of the amounts so paid to the participating members of DTC for subsequent remittance to the beneficial owners of the Bonds. See "THE BONDS - Book-Entry-Only System" herein. The initial Trustee is U.S. Bank National Association, Dallas, Texas (see "THE BONDS - Trustee").

AUTHORITY FOR ISSUANCE . . . The Bonds are being issued pursuant to the laws of the State of Texas, including Chapter 1207, Texas Government Code, as amended ("Chapter 1207"), a resolution of the Board of Directors (the "Board") of the Southmost Regional Water Authority (the "Authority") adopted on March 6, 2017 (the "Resolution"), and an Indenture of Trust and a Fifth Supplemental Indenture of Trust (collectively, referred to herein as the "Indenture"). As permitted by the provisions of Chapter 1207, the Board, in the Resolution, delegated the authority to certain Authority or Board officials to execute an Approval Certificate establishing the final pricing terms for the Bonds.

The Bonds are special limited obligations of the Authority payable, on a parity with the Series 2006 Bonds, the Series 2009 Bonds, and the Series 2012 Bonds (collectively, the "Previously Issued Bonds") and any additional bonds hereinafter issued pursuant to the Indenture, solely from, and secured by a lien on and pledge of solely from (1) Pledged Revenues, including all of the Authority's right, title and interest in and to the Pledged Contract Payments (as defined in the Indenture) to be made by the Public Utilities Board of the City of Brownsville, Texas, acting on behalf of the City of Brownsville, Texas, City of Los Fresnos, Texas, Town of Indian Lake, Texas, Valley Municipal Utility District No. 2, and Brownsville Navigation District (collectively, the "Participating Customers") to the Authority under separate Water Supply Contracts, as amended (the "Water Supply Contracts"), between each Participating Customer and the Authority; (2) Pledged Funds (as defined in the Indenture); and (3) any and all property pledged as additional security with the Trustee by the Authority under the Indenture (collectively, the "Trust Estate"). The Indenture provides that the Reserve Fund Requirement (as defined in the Indenture) of the Debt Service Reserve Fund (as defined in the Indenture) may be satisfied in whole or in part with one or more reserve fund surety policies therein. Pursuant to the Water Supply Contracts, the Authority provided for the construction of the Project to enable the Authority to treat and transmit water to the Participating Customers, and the Participating Customers are unconditionally obligated to pay to the Authority, as a maintenance and operation expense of their respective utility systems, all amounts necessary to pay Debt Service (as defined in the Indenture) on the Bonds, Notes, and Obligations (each defined in the Indenture) issued under the Indenture, including the Bonds and the Previously Issued Bonds, and to fund and maintain an operations and maintenance reserve fund. See "APPENDIX E – Definitions and Excerpts of Indenture and Fifth Supplemental Indenture." **The Bonds do not constitute an obligation, either special, general or moral of the State of Texas, the Participating Customers or any political subdivisions or entities thereof. The Authority does not have the power to levy or collect ad valorem taxes.**

PURPOSE . . . Proceeds from the sale of the Bonds will be used to (1) currently refund the outstanding obligations of the Authority described in SCHEDULE I – Schedule of Refunded Bonds (the "Refunded Bonds") in order to achieve a debt service savings; and (2) pay costs related to the issuance of the Bonds.

BOND INSURANCE . . . The scheduled payment of principal and interest on the Bonds when due will be guaranteed under a municipal bond insurance policy to be issued concurrently with the delivery of the Bonds by Build America Mutual Assurance Company ("BAM"). (See "BOND INSURANCE" herein).



See Maturity Schedule on Inside Cover

THIS COVER PAGE CONTAINS INFORMATION FOR QUICK REFERENCE ONLY. IT IS NOT A SUMMARY OF THE ISSUE. INVESTORS MUST READ THE ENTIRE OFFICIAL STATEMENT TO OBTAIN INFORMATION ESSENTIAL TO THE MAKING OF AN INFORMED INVESTMENT DECISION.

LEGALITY . . . The Bonds are offered for delivery when, as and if issued and received by the initial purchaser thereof named below (the "Underwriter") and subject to the approving opinion of the Attorney General of Texas and the approval of certain legal matters by Andrews Kurth Kenyon LLP, Bond Counsel, Houston, Texas (see "APPENDIX G - Form of Bond Counsel's Opinion"). Certain legal matters will be passed upon for the Authority by Davidson, Troilo, Ream & Garza, P.C., San Antonio, Texas, General Counsel. Certain matters will be passed on for the Underwriter by Locke Lord LLP, Dallas, Texas. The fees of Counsel to the Underwriter for their services are contingent upon the delivery of the Bonds.

DELIVERY . . . It is expected that the Bonds will be available for delivery through The Depository Trust Company on or about April 18, 2017 (the "Delivery Date").

RBC CAPITAL MARKETS

REDEMPTION OPTION . . . The Authority reserves the right, at its option, to redeem the Bonds having stated maturities on and after September 1, 2028, in whole or in part in principal amounts of \$5,000 or any integral multiple thereof, on September 1, 2027, or any date thereafter, at par plus accrued interest to the date of redemption (see "THE BONDS - Optional Redemption").

MATURITY SCHEDULE
\$9,255,000
SOUTHMOST REGIONAL WATER AUTHORITY
WATER SUPPLY CONTRACT REVENUE REFUNDING BONDS, SERIES 2017
(DESALINATION PLANT PROJECT)

CUSIP Prefix: 84455L

Maturity (September 1)	Principal Amount	Interest Rate	Initial Yield ⁽¹⁾	CUSIP ⁽²⁾
2019	\$ 935,000	3.000%	1.500%	FC6

2028	1,540,000	4.000%	2.850% ⁽³⁾	FD4
2029	1,600,000	4.000%	2.950% ⁽³⁾	FE2
2030	1,660,000	4.000%	3.050% ⁽³⁾	FF9
2031	1,725,000	4.000%	3.150% ⁽³⁾	FG7
2032	1,795,000	4.000%	3.250% ⁽³⁾	FH5

(Interest accrues from the Delivery Date)

⁽¹⁾ Yield represents the initial offering yield to the public which has been established by the Underwriter for offers to the public and which may be subsequently changed by the Underwriter and is the sole responsibility of the Underwriter.

⁽²⁾ CUSIP numbers have been assigned to the Bonds by CUSIP Global Services, managed by S&P Global Market Intelligence on behalf of the American Bankers Association, and are included solely for the convenience of the owners of the Bonds. None of the Authority, the Financial Advisor, nor the Underwriter are responsible for the selection or correctness of the CUSIP numbers set forth herein. CUSIP is a registered trademark of the American Bankers Association.

⁽³⁾ Yield calculated based upon the assumption that the Bonds designated and sold at a premium will be redeemed on September 1, 2027, the first optional redemption date for the Bonds, at a redemption price of par plus accrued interest to the redemption date.

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USE OF INFORMATION

THE BONDS HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, IN RELIANCE UPON EXEMPTIONS CONTAINED IN SUCH ACT. THE REGISTRATION OR QUALIFICATION OF THE BONDS IN ACCORDANCE WITH APPLICABLE PROVISIONS OF SECURITIES LAW OF THE STATES IN WHICH THE BONDS HAVE BEEN REGISTERED OR QUALIFIED AND THE EXEMPTION FROM REGISTRATION OR QUALIFICATION IN OTHER STATES CANNOT BE REGARDED AS A RECOMMENDATION THEREOF.

IN MAKING AN INVESTMENT DECISION, INVESTORS MUST RELY ON THEIR OWN EXAMINATION OF THE TERMS OF THIS OFFERING, INCLUDING THE MERITS AND RISKS INVOLVED. THE BONDS HAVE NOT BEEN RECOMMENDED BY ANY FEDERAL OR STATE SECURITIES COMMISSION OR REGULATORY AUTHORITY. FURTHERMORE, THE FOREGOING AUTHORITIES HAVE NOT CONFIRMED THE ACCURACY OR DETERMINED THE ADEQUACY OF THIS OFFICIAL STATEMENT. ANY REPRESENTATION TO THE CONTRARY MAY BE A CRIMINAL OFFENSE.

The information set forth herein has been furnished by the Authority and the Participating Customers and includes information obtained from other sources which are believed to be reliable, but is not guaranteed as to accuracy or completeness, and is not to be construed as a representation, by the Underwriter. The information and expressions of opinion contained herein are subject to change without notice and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the Authority or the Participating Customers or the other matters described herein since the date hereof.

This Official Statement includes descriptions and summaries of certain events, matters and documents. Such descriptions and summaries do not purport to be complete and all such descriptions, summaries and references thereto are qualified in their entirety by reference to this Official Statement in its entirety and to each such document, copies of which may be obtained from the Authority or from the Financial Advisor to the Authority. Any statements made in this Official Statement or the appendices hereto involving matters of opinion or estimates, whether or not so expressly stated, are set forth as such and not as representations of fact, and no representation is made that any of such opinions or estimates will be realized.

This Official Statement is delivered in connection with the sale of securities referred to herein and may not be produced or used, in whole or in part, for any other purposes.

This Official Statement does not constitute an offer to sell or the solicitation of an offer to buy nor shall there be any sale of the Bonds in any jurisdiction in which it is unlawful to make such offer, solicitation or sale. No dealer, salesman or other person has been authorized by the Authority or the Participating Customers to give any information or to make any representation other than those contained herein, and if given or made, such other information or representation must not be relied upon as having been authorized by the Authority or the Participating Customers or any other person. The information and expressions of opinion herein are subject to change without notice, and neither the delivery of this Official Statement nor any sale made hereunder shall, under any circumstances, create the implication that there has been no change in the matters described herein since the date hereof.

The prices and other terms respecting the offering and sale of the Bonds may be changed from time to time by the Underwriter after the Bonds are released for sale, and the Bonds may be offered and sold at prices other than the initial offering prices, including sales to dealers who may sell the Bonds into investment accounts.

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITER MAY OVER-ALLOT OR EFFECT TRANSACTIONS THAT STABILIZE OR MAINTAIN THE MARKET PRICES OF THE BONDS AT A LEVEL ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

Build America Mutual Assurance Company (“BAM”) makes no representation regarding the Bonds or the advisability of investing in the Bonds. In addition, BAM has not independently verified, makes no representation regarding, and does not accept any responsibility for the accuracy or completeness of this Official Statement or any information or disclosure contained herein, or omitted herefrom, other than with respect to the accuracy of the information regarding BAM, supplied by BAM and presented under the heading “Bond Insurance” and “Appendix G - Specimen Municipal Bond Insurance Policy”.

None of the Authority, the Financial Advisor or the Underwriter makes any representation or warranty with respect to the information contained in this Official Statement regarding the Depository Trust Company (“DTC”) or its Book-Entry-Only System described under “THE BONDS–Book-Entry-Only System” or Build America Mutual Assurance Company or its municipal bond insurance policy described under “BOND INSURANCE”.

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OFFICIAL STATEMENT SUMMARY

This summary is subject in all respects to the more complete information and definitions contained or incorporated in this Official Statement. The offering of the Bonds to potential investors is made only by means of this entire Official Statement. No person is authorized to detach this summary from this Official Statement or to otherwise use it without the entire Official Statement.

THE AUTHORITY Southmost Regional Water Authority (the "Authority") is a conservation and reclamation district organized pursuant to Article XVI, Section 59 of the Texas Constitution and is a governmental agency and a body politic and corporation of the State of Texas, created by Tex. Laws, 1981, 67th Legislature, Regular Session, Chapter 511 (the "Act"). The Authority is managed by a board of directors (the "Board"), which is comprised of six directors of which five directors are appointed by the governing bodies of each of the Participating Customers (see "THE AUTHORITY AND THE WATER SUPPLY CONTRACTS – The Authority" herein).

THE BONDS Southmost Regional Water Authority Water Supply Contract Revenue Refunding Bonds, Series 2017 (Desalination Plant Project) (the "Bonds") are being issued pursuant to the provisions of an Indenture of Trust dated as of December 1, 2002 and a Fifth Supplemental Indenture of Trust dated as of April 1, 2017 (collectively, the "Indenture").

PAYMENT OF INTEREST Interest on the Bonds accrues from the Delivery Date, and is payable on September 1, 2017, and each March 1 and September 1 thereafter until stated maturity or prior redemption (see "THE BONDS - Description of the Bonds" and "THE BONDS - Optional Redemption").

AUTHORITY FOR ISSUANCE The Bonds are being issued pursuant to the laws of the State of Texas, including Chapter 1207, Texas Government Code, as amended ("Chapter 1207"), a resolution of the Board of Directors (the "Board") of the Southmost Regional Water Authority (the "Authority") adopted on March 6, 2017 (the "Resolution"), and the Indenture. As permitted by the provisions of Chapter 1207, the Board, in the Resolution, delegated the authority to certain Authority or Board officials to execute an Approval Certificate establishing the final pricing terms for the Bonds.

SECURITY FOR THE BONDS The Bonds are special limited obligations of the Authority payable, on a parity with the Series 2006 Bonds, the Series 2009 Bonds, and the 2012 Bonds (collectively, the "Previously Issued Bonds") and any additional bonds hereinafter issued pursuant to the Indenture, solely from, and secured by a lien on and pledge of solely from (1) Pledged Revenues, including all of the Authority's right, title and interest in and to the Pledged Contract Payments (as defined in the Indenture) to be made by the Participating Customers (defined herein) to the Authority under the Water Supply Contracts (defined herein); (2) Pledged Funds (as defined in the Indenture); and (3) any and all property pledged as additional security with the Trustee by the Authority under the Indenture (collectively, the "Trust Estate"). Pursuant to the Water Supply Contracts, the Authority provided for the construction of the Project to enable the Authority to treat and transmit water to the Participating Customers, and the Participating Customers are unconditionally obligated to pay to the Authority, as a maintenance and operation expense of their respective utility systems, all amounts necessary to pay Debt Service (as defined in the Indenture) on the Bonds, Notes, and Obligations (each as defined in the Indenture) issued under the Indenture, including the Bonds and the Previously Issued Bonds, and to fund and maintain an operations and maintenance reserve fund. See "APPENDIX E – Definitions and Excerpts of Indenture and Fifth Supplemental Indenture."

Owners of the Bonds shall never have the right to demand payment of the Bonds or interest thereon out of any funds raised or to be raised by taxation or to have any claim against any property or revenues of the Participating Customers or the Authority except for the specific revenues and funds herein described. The Bonds do not constitute an obligation, either special, general or moral of the Participating Customers or any political subdivisions or entities thereof. The Authority does not have the power to levy or collect ad valorem taxes.

WATER SUPPLY CONTRACTS The Authority and the Participating Customers entered into Water Supply Contracts, dated as of December 1, 2002 (the "Original Contract Date"), as amended by the First Amendment dated as of November 1, 2009 (the "First Amendment"), and as amended by the Second Amendment dated as of July 1, 2012 (collectively, the "Water Supply Contracts"). The Water Supply Contracts remain in effect for a period of 30 years following the Original Contract Date or until all of the principal, premium if any, and interest on all Previously Issued Bonds, the Bonds, and any additional bonds have been paid in full or provision is made for such payment. Pursuant to each respective Water Supply Contract, the Participating Customers have unconditionally agreed to pay to the Authority such sums as required to pay (1) operation and maintenance expenses incurred by the Authority with respect to the Project, (2) Debt Service on all currently outstanding Bonds, Notes, and Obligations, including the Previously Issued Bonds and the Bonds, (3) all amounts required to establish, restore and maintain an amount equal to the Reserve Fund Requirement in the Debt Service Reserve Fund, (4) all other debt service obligation expenses and (5) a separate operations and maintenance reserve fund which is to be used for certain operations and

maintenance expenses of the System (as defined in the Indenture). Such payments are an unconditional obligation of the Participating Customers and are payable regardless of whether or not the Project is completed, operable, operated or retired and notwithstanding the suspension, interruption, interference, reduction or curtailment of operation of the Project or the delivery of treated water, regardless of the cause or origin thereof. Such payments are not subject to any reduction, whether offset or otherwise, and are not conditional upon performance by the Authority under the Water Supply Contracts, or any other lease, agreement or other obligation of the Authority. See “APPENDIX E – Definitions and Excerpts of Indenture and Fifth Supplemental Indenture.”

- DEBT SERVICE RESERVE FUND...** Under the Indenture, the Authority is required to fund the Debt Service Reserve Fund in an amount equal to the Reserve Fund Requirement, which may vary but shall never be less than the maximum annual debt service on the currently outstanding Previously Issued Bonds, the Bonds, and any other Bonds, Notes, and Obligations issued under the Indenture based on calculations performed as of the date of issuance of any Bonds, Notes or Obligations. The Indenture further provides that the Debt Service Reserve Fund may be funded in whole, or in part, with one or more reserve fund surety policies. See “APPENDIX E – Definitions and Excerpts of the Indenture and Fifth Supplemental Indenture”. Upon the issuance of the Bonds, the Reserve Fund Requirement will be \$2,465,325, a portion of which amount will be funded by a municipal bond debt service reserve surety policy to be issued by Build America Mutual Assurance Company (“BAM”).
- PROJECT OPERATOR.....** The Authority has previously entered into a services contract with Public Utilities Board of the City of Brownsville, Texas (“BPUB”) for the operation of the Project. Pursuant to the contract, BPUB supplies all labor for the operation of the Project and will perform routine maintenance.
- OPTIONAL REDEMPTION.....** The Authority reserves the right, at its option, to redeem the Bonds having stated maturities on and after September 1, 2028, in whole or in part in principal amounts of \$5,000 or any integral multiple thereof, on September 1, 2027, or any date thereafter, at the par value thereof plus accrued interest to the date of redemption (see “THE BONDS - Optional Redemption”).
- TAX EXEMPTION.....** In the opinion of Bond Counsel, the interest on the Bonds will be excludable from gross income for federal income tax purposes under existing law, subject to the matters described under the caption “TAX MATTERS” herein, including the alternative minimum tax on corporations. The Authority has designated the Bonds as qualified tax-exempt obligations (see “TAX MATTERS – Qualified Tax-Exempt Obligations”).
- USE OF PROCEEDS.....** Proceeds from the sale of the Bonds will be used to (1) currently refund the outstanding obligations of the Authority described in SCHEDULE I – Schedule of Refunded Bonds (the “Refunded Bonds”) in order to achieve a debt service savings; and (2) pay costs related to the issuance of the Bonds.
- RATINGS.....** The Bonds have been rated “AA” by S&P Global Ratings, a division of S&P Global Inc. (“S&P”) by virtue of a municipal bond insurance policy issued by BAM. The Bonds and the presently outstanding revenue debt of the Authority have been given an underlying unenhanced rating of “A2” by Moody’s Investors Service, Inc. (“Moody’s”). The presently outstanding revenue supported debt of the Authority has an underlying rating of “A+” by Fitch. The Series 2006 Bonds and the Series 2012 Bonds are insured by commercial insurance companies (see “BOND INSURANCE”, “BOND INSURANCE GENERAL RISKS”, and “OTHER INFORMATION - Ratings”).
- MUNICIPAL BOND INSURANCE....** The scheduled payment of principal and interest on the Bonds when due will be guaranteed under a municipal bond insurance policy to be issued concurrently with the delivery of the Bonds by BAM. (See “BOND INSURANCE” and “BOND INSURANCE GENERAL RISKS” herein).
- BOOK-ENTRY-ONLY SYSTEM.....** The definitive Bonds will be initially registered and delivered only to Cede & Co., the nominee of DTC pursuant to the Book-Entry-Only System described herein. Beneficial ownership of the Bonds may be acquired in denominations of \$5,000 or integral multiples thereof. No physical delivery of the Bonds will be made to the beneficial owners thereof. Principal of, premium, if any, and interest on the Bonds will be payable by the Trustee to Cede & Co., which will make distribution of the amounts so paid to the participating members of DTC for subsequent remittance to the beneficial owners of the Bonds (see “THE BONDS - Book-Entry-Only System”).
- PAYMENT RECORD.....** Neither the Authority nor the BPUB has ever defaulted in payment of their respective bonded indebtedness.

SOUTHMOST REGIONAL WATER AUTHORITY

BOARD OF DIRECTORS

Rafael Vela President
Roger Nelson Vice-President/Groundwater
Valley Municipal Utility District No. 2
Mayor Hipolito Narvaez Vice-President/Rio Grande
City of Los Fresnos
Ralph Cowen Treasurer
Brownsville Navigation District
Honorable Barbara Collum Secretary
Town of Indian Lake
John S. Bruciak, P.E. Deputy Secretary/Treasurer
Public Utilities Board of the City of Brownsville, Texas

ADMINISTRATION OF THE PUBLIC UTILITIES BOARD OF THE CITY OF BROWNSVILLE, TEXAS

John S. Bruciak, P.E. General Manager & Chief Executive Officer
Fernando Saenz, P.E Assistant General Manager & Chief Operating Officer
Leandro G. García, CPA Chief Financial Officer

CONSULTANTS AND ADVISORS

General Counsel Davidson Troilo Ream & Garza, P.C.
San Antonio, Texas
Bond Counsel Andrews Kurth Kenyon LLP
Houston, Texas
Financial Advisor Estrada Hinojosa & Company, Inc.
Dallas, Texas

For additional information regarding the Authority, please contact:

Mr. John S. Bruciak, P.E., General Manager and Chief
Executive Officer of BPUB
or
Mr. Leandro G. Garcia, Chief Financial Officer of BPUB
Southmost Regional Water Authority
c/o Public Utilities Board of the City of Brownsville, Texas
1425 Robinhood Drive
Brownsville, Texas 78521
Tel – (956) 983-6173
Fax – (956) 983-6175
jbruciak@brownsville-pub.com
lgarcia@brownsville-pub.com

Estrada Hinojosa & Company, Inc.
Mr. Noe Hinojosa
1717 Main Street
Suite 4700, LB 47
Dallas, Texas 75201
Tel – (214) 658-1670
Fax – (214) 658-1671
bgarza@estradahinojosa.com

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OFFICIAL STATEMENT

RELATING TO

\$9,255,000

SOUTHMOST REGIONAL WATER AUTHORITY WATER SUPPLY CONTRACT REVENUE REFUNDING BONDS, SERIES 2017 (DESALINATION PLANT PROJECT)

INTRODUCTION

This Official Statement provides certain information with respect to the \$9,255,000 Southmost Regional Water Authority Water Supply Contract Revenue Refunding Bonds, Series 2017 (Desalination Plant Project) (the “Bonds”). The Southmost Regional Water Authority (the “Authority”), is a conservation and reclamation district organized pursuant to Article XVI, Section 59 of the Texas Constitution and is a governmental agency and a body politic and corporate of the State of Texas, created by Tex. Laws, 1981, 67th Legislative, Regular Session, Chapter 511 (the “Act”). The Bonds are issued pursuant to provisions of an Indenture of Trust dated as of December 1, 2002 and a Fifth Supplemental Indenture of Trust dated as of April 1, 2017 (collectively the “Indenture”).

This Official Statement includes a description of the Authority, the Participating Customers, the Bonds, the Indenture and the Water Supply Contracts (defined herein), pursuant to which the Bonds are payable. Such descriptions and summaries do not purport to be comprehensive or definitive. All references herein to the Indenture and the Water Supply Contracts are qualified by reference to the Indenture and the Water Supply Contracts, respectively, in their entirety, and all references to the Bonds are qualified by reference to the form of the Bonds and the information with respect to the Bonds included in the Indenture. Statements made in this Official Statement involving estimates or projections, whether or not expressly identified as such, must not be construed as statements of fact or representations that such estimates or projections will be attained or will approximate actual results. Certain capitalized terms used in this Official Statement have the meaning given to them in the Indenture or as defined herein, except as otherwise indicated herein.

The Bonds are special limited obligations of the Authority payable, on a parity with the Previously Issued Bonds and any additional Bonds hereinafter issued pursuant to the Indenture, solely from, and secured by a lien on and pledge of solely from the Trust Estate. **Owners of the Bonds shall never have the right to demand payment of the Bonds or interest thereon out of any funds raised or to be raised by taxation or to have any claim against any property or revenues of the Participating Customers or the Authority except for the specific revenues and funds herein described. The Bonds do not constitute an obligation, either special, general or moral of the Participating Customers or any political subdivisions or entities thereof. The Authority does not have the power to levy or collect ad valorem taxes.**

PURPOSE OF THE BONDS

PURPOSE OF THE BONDS . . . Proceeds from the sale of the Bonds will be used to (1) currently refund the outstanding obligations of the Authority described in SCHEDULE I – Schedule of Refunded Bonds (the “Refunded Bonds”) in order to achieve a debt service savings; and (2) pay costs related to the issuance of the Bonds.

REFUNDED BONDS . . . The Refunded Bonds, and interest due thereon, are to be paid on the scheduled redemption date from funds to be deposited with U.S. Bank National Association, Houston, Texas, as escrow agent, (the “Escrow Agent”) pursuant to the provisions of the Escrow Agreement (the “Escrow Agreement”) between the Authority and the Escrow Agent.

The Fifth Supplemental Indenture provides that the Authority will deposit certain proceeds of the sale of the Bonds, along with other lawfully available funds of the Authority (if any), with the Escrow Agent in the amount necessary and sufficient to accomplish the discharge and final payment of the Refunded Bonds at their scheduled date of early redemption (the “Redemption Date”). Such funds shall be held by the Escrow Agent in an escrow fund (the “Escrow Fund”) irrevocably pledged to the payment of principal of and interest on the Refunded Bonds.

Estrada Hinojosa & Company, Inc., in its capacity as financial advisor to the Authority, will certify as to the sufficiency of the amount initially deposited to the Escrow Fund, without regard to investment (if any), to pay the principal of and interest on the Refunded Bonds, when due, at the Redemption Date (the “Sufficiency Certificate”).

Amounts on deposit in the Escrow Fund shall, until such time as needed for their intended purpose, be (i) held uninvested in cash and/or (ii) invested in certain direct, noncallable obligations of the United States of America (including obligations unconditionally guaranteed by the United States of America). Cash and investments (if any) held in the Escrow Fund shall not be available to pay debt service requirements on the Bonds.

Prior to, or simultaneously with, the issuance of the Bonds, the Authority will give irrevocable instructions to provide notice to the owners of the Refunded Bonds that the Refunded Bonds will be redeemed prior to stated maturity on which date money will be made available to redeem the Refunded Bonds from money held under the Escrow Agreement.

By the deposit of Bond proceeds and cash, if any, with the Escrow Agent pursuant to the Escrow Agreement, and the investment thereof as described above (if such funds are invested), the Authority will have effectuated the defeasance of the Refunded Bonds pursuant to the terms of the indenture of trust authorizing their issuance. It is the opinion of Bond Counsel that, as a result of such defeasance, and in reliance upon the Sufficiency Certificate, the Refunded Bonds will no longer be an outstanding debt obligation of the Authority under the indenture of trust authorizing their issuance, but will be payable solely from the amounts on deposit in the Escrow Fund and held for such purpose by the Escrow Agent, and that the Refunded Bonds will be defeased and are not to be included in or considered to be indebtedness of the System (as defined in the Indenture) for the purpose of a limitation of indebtedness or for any other purpose.

The Authority has covenanted in the Escrow Agreement to make timely deposits to the Escrow Fund, from lawfully available funds, of any additional amounts required to pay the principal of and interest on the Refunded Bonds, if for any reason, the cash balances on deposit or scheduled to be on deposit in the Escrow Fund be insufficient to make such payment.

THE BONDS

DESCRIPTION OF THE BONDS . . . The Bonds are dated April 1, 2017, and mature on September 1 in each of the years, in the amounts and at the interest rates shown on the inside cover page hereof. Interest will be computed on the basis of a 360-day year of twelve 30-day months. The Bonds will bear interest from the Delivery Date, or from the most recent date to which interest has been paid or duly provided for, and will be payable on March 1 and September 1, commencing September 1, 2017 until stated maturity or prior redemption. The Bonds will be issued only in fully registered form in any integral multiple of \$5,000 for any one maturity and will be initially registered and delivered only to Cede & Co., the nominee of The Depository Trust Company ("DTC") pursuant to the Book-Entry-Only System described herein. **No physical delivery of the Bonds will be made to the beneficial owners thereof.** Principal of, premium, if any, and interest on the Bonds will be payable by the Trustee to Cede & Co., which will make distribution of the amounts so paid to the beneficial owners of the Bonds. See "Book-Entry-Only System" herein.

AUTHORITY FOR ISSUANCE . . . The Bonds are being issued pursuant to the laws of the State of Texas, including Chapter 1207, Texas Government Code, as amended ("Chapter 1207"), a resolution of the Board of Directors (the "Board") of the Authority adopted on March 6, 2017 (the "Resolution"), and an Indenture of Trust and a Fifth Supplemental Indenture of Trust (collectively, referred to herein as the "Indenture"). As permitted by the provisions of Chapter 1207, the Board, in the Resolution, delegated the authority to certain Authority or Board officials to execute an Approval Certificate establishing the final pricing terms for the Bonds.

SECURITY AND SOURCE OF PAYMENT . . . The Bonds are special limited obligations of the Authority payable, on a parity with the Previously Issued Bonds and any additional bonds hereinafter issued pursuant to the Indenture, solely from, and secured by a lien on and pledge of solely from (1) Pledged Revenues, including all of the Authority's right, title and interest in and to the Pledged Contract Payments (as defined in the Indenture) to be made by the Participating Customers (defined herein) to the Authority under the Water Supply Contracts (defined herein); (2) Pledged Funds (as defined in the Indenture); and (3) any and all property pledged as additional security with the Trustee by the Authority under the Indenture (collectively, the "Trust Estate"). Pursuant to the Water Supply Contracts, the Authority provided for the construction of the Project to enable the Authority to treat and transmit water to the Participating Customers, and the Participating Customers are unconditionally obligated to pay to the Authority, as a maintenance and operation expense of their respective utility systems, all amounts necessary to pay Debt Service (as defined in the Indenture) on the Bonds, Notes, and Obligations (each as defined in the Indenture) issued under the Indenture, including the Bonds and the Previously Issued Bonds, and to fund and maintain an operations and maintenance reserve fund. See "APPENDIX E – Definitions and Excerpts of Indenture and Fifth Supplemental Indenture."

Owners of the Bonds shall never have the right to demand payment of the Bonds or interest thereon out of any funds raised or to be raised by taxation or to have any claim against any property or revenues of the Participating Customers or the Authority except for the specific revenues and funds herein described. The Bonds do not constitute an obligation, either special, general or moral of the Participating Customers or any political subdivisions or entities thereof. The Authority does not have the power to levy or collect ad valorem taxes.

Under the Water Supply Contracts, the Authority is obligated to provide for the benefit of the Participating Customers, the financing and construction of the Project, and the Participating Customers have unconditionally agreed to pay to the Authority such sums as are required to pay (1) operation and maintenance expenses incurred by the Authority with respect to the Project, (2) Debt Service on all Bonds, Notes and Obligations issued under the Indenture, which shall include the payment of principal, redemption premium, if any, and interest on the currently outstanding Previously Issued Bonds and the Bonds, (3) all amounts required to establish, restore and maintain an amount equal to the Reserve Fund Requirement in the Debt Service Reserve Fund, (4) all other debt service obligation expenses, and (5) a separate operations and maintenance reserve fund which is to be used for certain operation and maintenance expenses of the System. Such payments are an unconditional obligation of the Participating Customers and are payable regardless of whether or not the Project is completed, operable, operated or retired and notwithstanding the suspension, interruption, interference reduction or curtailment of operation of the Project or the delivery of treated water, regardless of the cause or origin thereof. Such payments are not subject to any reduction, whether offset or otherwise, and are not conditional upon performance by the Authority under the Water Supply Contracts, or any other lease, agreement or other obligation of the Authority. See "APPENDIX E - Definitions and Excerpts of Indenture and Fifth Supplemental Indenture."

THE INDENTURE . . . The Indenture establishes the following separate funds for the deposit of the proceeds from the sale of the Bonds and the Pledged Revenues: (1) Construction Fund, (2) Debt Service Fund, (3) Debt Service Reserve Fund, and (4) Rebate Fund. The Fifth Supplemental Indenture of Trust creates the (i) Series 2017 Construction Fund, which shall contain a sub-account entitled Series 2017 Costs of Issuance Account, (ii) Series 2017 Rebate Account and (iii) Series 2017 Debt Service Fund, which shall contain an account entitled Series 2017 Escrow Account. Other than the Construction Fund and the Rebate Fund, the Trustee shall maintain all Funds and Accounts created under the Indenture. The Authority reserves the right to elect that the Construction Account reside with the Depository. The Authority may establish separate accounts within all Funds. A portion of the proceeds from the sale of the Bonds will be deposited in the Construction Fund to pay Costs of Issuance. The Debt Service Fund and Debt Service Reserve Fund, and proceeds deposited thereby, constitute the “Pledged Funds,” which are solely for the payment of interest and principal on the Bonds; except that to the extent the amount in the Debt Service Reserve Fund exceeds the Reserve Fund Requirements, excess funds therein may be transferred to the Debt Service Fund or to any other Fund or Account. A balance must be maintained in the Debt Service Reserve Fund equal to the Reserve Fund Requirement, which may vary but will never be less than the maximum annual debt service in the current or any future fiscal year based upon calculations of Aggregate Debt Service for each such fiscal year performed as of the date of issuance of the Bonds. If any money is ever withdrawn from the Debt Service Reserve Fund or amounts are drawn under a reserve fund surety policy for the purpose of paying the principal of or interest on the Bonds, the Authority is required under the Indenture to deposit into the Debt Service Reserve Fund the amount necessary to restore the minimum balance required (which sum may be deposited in equal monthly payments for a period not to exceed twelve (12) months).

In lieu of cash or investment securities, the Reserve Fund Requirement may be satisfied in whole or in part with one or more Reserve Fund Surety Policies at any time. Such Reserve Fund Surety Policies may be drawn upon only after all other amounts in the Debt Service Reserve Fund have been used or applied, and other amounts in the Debt Service Reserve Fund may be used to reimburse and repay issuers of reserve fund surety policies for amounts drawn thereon, together with interest thereon and related costs, all as may be more fully provided for by a Supplemental Indenture. In addition, with respect to any additional Bonds, Notes or Obligations, the Authority may provide in a Supplemental Indenture that the Debt Service Reserve Fund Requirement in the Debt Service Reserve Fund be funded (1) from the proceeds of such additional Bonds or Notes, (2) with a Reserve Fund Surety Policy, (3) from Pledged Revenues within twelve (12) months from the date of sale of such additional Bonds or Notes, (4) from any other source, or (5) from any combination thereof.

Money held in the Rebate Fund shall be used to make payments to the United States of America pursuant to the requirements of the Internal Revenue Code, the Regulations adopted thereunder and the Indenture so the Bonds will not be “arbitrage bonds.” Earnings on any Fund established under the Indenture shall be transferred to the Rebate Fund if required by a Supplemental Indenture.

Money on deposit in the above Funds may be invested in any securities authorized for investment of Authority funds by the laws of the State of Texas, currently the Texas Public Funds Investment Act, Chapter 2256, Texas Government Code, as amended.

FLOW OF FUNDS . . . The Indenture provides that Pledged Revenues shall be used to make or provide for all payments, deposits, and transfers required therein as follows:

1. On or before the 20th day of each month, and at such other times as shall be set forth in any Supplemental Indenture, there shall be paid into the Debt Service Fund from the Pledged Revenues, amounts which, when added to other amounts in the Debt Service Fund and available for such purposes, will provide for the accumulation in approximately equal installments of the amount required to pay the Debt Service on all Bonds, Notes and Obligations, including the following:

- (a) any interest to become due and payable on each Series of Outstanding Bonds, any additional Bonds or any Notes on the next Interest Payment Date for such Series; and
- (b) any principal scheduled to become due and payable on each series of Bonds within the following twelve months; and
- (c) if provided in any Supplemental Indenture, any provision for the payment of principal on any Notes; and
- (d) unless otherwise provided in any Supplemental Indenture, any amounts due on Obligations; and
- (e) unless otherwise provided in any Supplemental Indenture, any amounts required to pay all related Expenses.

Expenses are defined in the Indenture as the ongoing fees and expenses of the Authority relating to the Bonds, Notes and Obligations, including the Authority’s fees and expenses relating to: (i) Trustees, Paying Agents, Registrars, Authenticating Agents, Securities Dealers, Securities Depositories, or other Fiduciaries; (ii) tax rebate, financial and legal consultants; (iii) insurers; (iv) remarketing, indexing or similar agreements; and (v) Credit Agreements, Hedge Agreements, Investment Liquidity Facility agreements or reserve fund surety policies.

2. After the payments and transfers set out above, if the Debt Service Reserve Fund contains less than the Reserve Fund Requirement, there shall be paid into the Debt Service Reserve Fund from Pledged Revenues the amount required, if any, by a Supplemental Indenture to attain the Reserve Fund Requirement, which transfers shall continue until the Debt Service Reserve Fund contains the Reserve Fund Requirement; provided, however, that by Supplemental Indenture, the Authority may provide for other or greater transfers in connection with the purchase or acquisition of any reserve fund surety policy.

CERTAIN COVENANTS

The Authority has covenanted that so long as any Bonds, Notes or Obligations are outstanding, it will maintain the Water Supply Contracts in full force and effect and will use reasonable diligence to require the Participating Customers to perform and discharge each and all of the duties and obligations imposed upon the Participating Customers by the Water Supply Contracts. If the Participating Customers fail to make payments as required by the Water Supply Contracts and if it should appear that enforcement of the Water Supply Contracts has become ineffective or will be ineffective to the extent that a default in the payment of principal of or interest on the currently outstanding Bonds occurs or is threatened, the Authority will take all necessary action to preserve and protect the rights of the Owners of the currently outstanding Bonds, Notes or Obligations to assure payment of the principal of and interest on the Bonds.

AMENDMENTS TO INDENTURE

Amendments Requiring Consent. The Indenture provides that the terms and provisions of the Indenture may be amended upon the consent of the Owners of not less than 51% of the aggregate principal amount of all outstanding Bonds, Notes or Obligations which are affected by the amendment or modification. The Bond Insurer, if any, is deemed to be an Owner of the Bonds guaranteed by the Bond Insurer for all notice and consent purposes.

Amendments not Requiring Consent or Notice. The Authority may enter into Supplemental Indentures that may amend or modify the Indenture without consent or notice to the Owners, if such amendment or modification is for, among other matters, the following: (1) to authorize additional Bonds, Notes and other Obligations; (2) to add additional restrictions or limitations to the Indenture; (3) to add covenants and agreements not inconsistent with the Indenture; (4) to confirm or further assure any pledge under any Indenture or any Supplemental Indenture; (5) to add or modify the provisions of the Indenture to allow for the issuance of bonds that are junior and subordinate to the Bonds or Notes; (6) to change components of the Project; (7) to increase the interest rate or rates of any Bonds or Notes; (8) to cure ambiguities, supply any omissions, cure defects, or clarify other matters not inconsistent with the Indenture; (9) to comply with the requirements of a nationally recognized rating agency in order to obtain or maintain a rating on the Bonds and (10) to modify the Indenture to maintain or preserve federal tax exemption to the Bonds or Notes. See "APPENDIX E – Definitions and Excerpts of the Indenture and Fifth Supplemental Indenture."

ADDITIONAL OBLIGATIONS

The Authority reserves the right to issue an unlimited amount of additional Bonds and Notes to complete, repair, improve, enlarge or replace the Project provided that certain conditions in the Indenture are satisfied, including the following: (1) the Water Supply Contracts are amended or supplemented to provide that the Participating Customers will increase or adjust the Pledged Contract Payments under the Water Supply Contracts so that such payments will be sufficient to (a) pay the principal and interest on the additional Bonds or Notes and make all mandatory redemption or sinking fund installments as required by the Supplemental Indenture authorizing such additional Bonds or Notes, (b) increase and/or maintain the balance in the Debt Service Reserve Fund to the amount required by the Supplemental Indenture authorizing such additional Bonds or Notes and (c) pay all related Expenses (as defined in the Indenture) in connection with the additional Bonds or Notes; and (2) the Participating Customers provide a certificate executed by the Mayor, City Secretary and the City Finance Director to the effect that the Participating Customer is not in default as to any material covenant, condition or obligation prescribed by any ordinance authorizing its water and sewer system revenue bonds, notes or other obligations secured with revenues derived from the Participating Customers' Water and Sewer System.

The Authority also reserves the right to issue additional Bonds and Notes for the purpose of refunding currently outstanding bonds or notes without the consent of any Participating Customer provided that the refunding does not increase capital costs payable by the Participating Customers in any one fiscal year in which the refunding bonds are outstanding.

RESERVE FUND REQUIREMENT . . . The Fifth Supplemental Indenture provides that immediately after delivery of the Initial Bond, the Authority shall cause to be deposited from proceeds of the sale and delivery of the Bonds into the Debt Service Reserve Fund an amount which, together with funds then on deposit therein, will be equal to the average annual principal and interest requirements on the Bonds (the "Reserve Fund Requirement"); and no deposits shall need to be made into the Debt Service Reserve Fund as long as the money and investments in said Fund are at least equal in market value to the Reserve Fund Requirement. A portion of the Reserve Fund Requirement will be funded by a municipal bond debt service reserve surety policy to be issued by Build America Mutual Assurance Company upon issuance of the Bonds.

OPTIONAL REDEMPTION . . . The Authority reserves the right, at its option, to redeem the Bonds having stated maturities on and after September 1, 2028, in whole or in part in principal amounts of \$5,000 or any integral multiple thereof, on September 1, 2027, or any date thereafter, at par plus accrued interest to the date of redemption. If less than all of the Bonds are to be redeemed, the Authority may select the maturities and amounts of the Bonds to be redeemed. If less than all the Bonds of any maturity are to be redeemed, the Trustee (or DTC while the Bonds are in Book-Entry-Only form) shall determine by lot, or other customary method, the Bonds, or portions thereof, within such maturity to be redeemed. If a Bond (or any portion of the principal sum thereof) shall have been called for redemption and notice of such redemption shall have been given, such Bond (or the principal amount thereof to be redeemed) shall become due and payable on such redemption date and interest thereon shall cease to accrue from and after the redemption date, provided funds for the payment of the redemption price and accrued interest thereon are held by the Trustee on the redemption date.

NOTICE OF REDEMPTION . . . Not less than 30 days prior to a redemption date for the Bonds, the Authority shall cause a notice of redemption to be sent by United States mail, first class, postage prepaid, to the registered owners of the Bonds to be redeemed, in whole or in part, at the address of the registered owner appearing on the registration books of the Trustee at the close of business on the business day next preceding the date of mailing such notice. With respect to any optional redemption of the Bonds, unless certain prerequisites to such redemption required by the Fifth Supplemental Indenture have been met and money sufficient to pay the principal of and premium, if any, and interest on the Bonds to be redeemed will have been received by the Paying Agent/Registrar prior to the giving of such notice of redemption, such notice may state that said redemption is conditional upon the satisfaction of such prerequisites and receipt of such money by the Paying Agent/Registrar on or prior to the date fixed for such redemption or upon any prerequisite set forth in such notice of redemption. If a conditional notice of redemption is given and such prerequisites to the redemption are not fulfilled, such notice will be of no force and effect, the Authority will not redeem such Bonds, and the Paying Agent/Registrar will give notice in the manner in which the notice of redemption was given, to the effect that such Bonds have not been redeemed. ANY NOTICE SO MAILED SHALL BE CONCLUSIVELY PRESUMED TO HAVE BEEN DULY GIVEN, WHETHER OR NOT THE REGISTERED OWNER RECEIVES SUCH NOTICE. NOTICE HAVING BEEN SO GIVEN, THE BONDS CALLED FOR REDEMPTION SHALL BECOME DUE AND PAYABLE ON THE SPECIFIED REDEMPTION DATE, AND NOTWITHSTANDING THAT ANY BOND OR PORTION THEREOF HAS NOT BEEN SURRENDERED FOR PAYMENT, INTEREST ON SUCH BOND OR PORTION THEREOF SHALL CEASE TO ACCRUE.

SOURCES AND USES OF BOND PROCEEDS . . . Proceeds from the sale of the Bonds are expected to be expended as follows:

Sources of Funds:

Par amount of the Bonds	\$ 9,255,000.00
Premium	725,244.75
Issuer Contribution	54,530.96
Total Sources of Funds	<u>\$ 10,034,775.71</u>

Uses of Funds:

Deposit to Construction Fund	\$ 9,804,337.95
Underwriters' Discount	58,354.41
Cost of Issuance, including Bond Insurance Premium and Surety Premium	172,083.35
Total Uses of Funds	<u>\$ 10,034,775.71</u>

BOOK-ENTRY-ONLY SYSTEM . . . This section describes how ownership of the Bonds is to be transferred and how the principal of, premium, if any, and interest on the Bonds are to be paid to and credited by the Depository Trust Company ("DTC"), New York, New York, while the Bonds are registered in its nominee name. The information in this section concerning DTC and the Book-Entry-Only System has been provided by DTC for use in disclosure documents such as this Official Statement. The Authority, Authority's Financial Advisor and the Underwriter believe the source of such information to be reliable, but take no responsibility for the accuracy or completeness thereof.

The Authority cannot and does not give any assurance that (1) DTC will distribute payments of debt service on the Bonds, or redemption or other notices, to DTC Participants, (2) DTC Participants or others will distribute debt service payments paid to DTC or its nominee (as the registered owner of the Bonds), or redemption or other notices, to the Beneficial Owners, or that they will do so on a timely basis, or (3) DTC will serve and act in the manner described in this Official Statement. The current rules applicable to DTC are on file with the United States Securities and Exchange Commission, and the current procedures of DTC to be followed in dealing with DTC Participants are on file with DTC.

DTC will act as securities depository for the Bonds. The Bonds will be issued as fully-registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully-registered certificate will be issued for the Bonds, in the aggregate principal amount of such issue, and will be deposited with DTC.

DTC, the world's largest depository, is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 2.2 million issues of U.S. and non-U.S. equity corporate and municipal debt issues, and money market instruments from over 100 countries that its participants ("Direct Participants") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities Bonds. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("DTCC"). DTCC, in turn, is owned by a number of Direct Participants of DTC and Members of the National Securities Clearing Corporation, Fixed Income Clearing Corporation, and Emerging Markets Clearing Corporation (NSCC, FICC, and EMCC, also subsidiaries of DTCC), as well as the New York Stock Exchange, Inc., the American Stock Exchange, LLC., and the National Association of Securities Dealers, Inc. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("Indirect Participants"). DTC has a Standard & Poor's rating of "AA+". The DTC Rules applicable to its Participants are on file with the United States Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com.

Purchases of Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Bonds on DTC's records. The ownership interest of each actual purchaser of the Bonds ("Beneficial Owner") is in turn to be recorded on the Direct or Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interest in the Bonds are to be accomplished by entries made on the books of Direct Participants and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive Bonds representing their ownership interests in the Bonds, except in the event that use of the book-entry system for the Bonds is discontinued.

To facilitate subsequent transfers, all Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of Bonds with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Bonds, such as redemptions, tenders, defaults, and proposed amendments to the Bond documents. For example, Beneficial Owners of Bonds may wish to ascertain that the nominee holding the Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of notices be provided directly to them.

Redemption notices will be sent to DTC. If less than all of the Bonds within an issue are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such issue to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to the Bonds unless authorized by a Direct Participant in accordance with DTC's Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the Authority as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Redemption proceeds, principal and interest, and dividend payments on the Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the Authority or Trustee, on payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC (nor its nominee), the Trustee or the Authority, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of redemption proceeds, distributions, and dividend payments to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Authority or Trustee, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

A Beneficial Owner will give notice to elect to have its Bonds purchased or tendered, through its Participant, to the Trustee, and will effect delivery of such Bonds by causing the Direct Participant to transfer the Participant's interest in the Bonds, on DTC's records, to the Trustee. The requirement for physical delivery of Bonds in connection with an optional tender or a mandatory purchase will be deemed satisfied when the ownership rights in the Bonds are transferred by Direct Participants on DTC's records and followed by a book-entry credit of tendered Securities to the Trustee's DTC account.

DTC may discontinue providing its services as securities depository with respect to the Bonds at any time by giving reasonable notice to the Authority. Under such circumstances, in the event that a successor depository is not obtained, Bonds are required to be printed and delivered.

The Authority may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). In that event, Bonds will be printed and delivered.

The Trustee and the Authority, so long as the DTC book-entry system is used for the Bonds, will send any notice of redemption, notice of proposed amendment to the Indenture, or other notices with respect to such Bonds only to DTC. Any failure by DTC to advise any DTC Participant, or of any Direct Participant or Indirect Participant to notify the Beneficial Owners, of any notices and their contents or effect will not affect the validity of the redemption of the Bonds called for redemption or of any other action premised on any such notice. Redemption of portions of the Bonds by the Authority will reduce the outstanding principal amount of such Bonds held by DTC. In such event, DTC may implement, through its book-entry system, a redemption of such Bonds held for the account of DTC Participants in accordance with its own rules or other agreements with DTC Participants and then Direct Participants and Indirect Participants may implement a redemption of such Bonds from the Beneficial Owners. Any such selection of the Bonds to be redeemed will not be governed by the Indenture and will not be conducted by the Authority or the Trustee. Neither the Authority nor the Trustee will have any responsibility or obligation to Direct Participants, Indirect Participants, or the persons for whom DTC Participants act as nominees, with respect to the payments on the Bonds or the providing of notice to Direct Participants, Indirect Participants, or Beneficial Owners of the selection of portions of the Bonds for redemption.

Use of Certain Terms in Other Sections of this Official Statement. In reading this Official Statement it should be understood that while the Bonds are in the Book-Entry Only System, references in other sections of this Official Statement to registered owners should be read to include the person for which the Participant acquires an interest in the Bonds, but (i) all rights of ownership must be exercised through DTC and the Book-Entry Only System, and (ii) except as described above, notices that are to be given to registered owners under the Indenture will be given only to DTC.

Information concerning DTC and the Book-Entry Only System has been obtained from DTC and is not guaranteed as to accuracy or completeness by, and is not to be construed as a representation by the Authority, the Financial Advisor, or the Underwriter.

Effect of Termination of Book-Entry Only System. In the event that the Book-Entry Only System is discontinued by DTC or the use of the Book-Entry Only System is discontinued by the Authority, the following provisions set forth below under "Transfer, Exchange and Registration" will be applicable to the Bonds.

TRUSTEE . . . The initial Trustee is U.S. Bank National Association, Houston, Texas. In the Indenture, the Authority retains the right to replace the Trustee. The Authority covenants to maintain and provide a Trustee at all times until the Bonds are duly paid and any successor Trustee shall be a commercial bank or trust company or other entity duly qualified and legally authorized to serve as and perform the duties and services of Trustee for the Bonds. Upon any change in the Trustee for the Bonds, the Authority agrees to promptly cause a written notice thereof to be sent to each registered owner of the Bonds by United States mail, first class, postage prepaid, which notice shall also give the address of the new Trustee.

TRANSFER, EXCHANGE AND REGISTRATION . . . In the event the Book-Entry-Only System should be discontinued, the Bonds may be transferred and exchanged on the registration books of the Trustee only upon presentation and surrender to the Trustee and such transfer or exchange shall be without expense or service charge to the registered owner, except for any tax or other governmental charges required to be paid with respect to such registration, exchange and transfer. Bonds may be assigned by the execution of an assignment form on the respective Bonds or by other instrument of transfer and assignment acceptable to the Trustee. New Bonds will be delivered by the Trustee, in lieu of the Bonds being transferred or exchanged, at the designated office of the Trustee, or sent by United States mail, first class, postage prepaid, to the new registered owner or his designee. To the extent possible, new Bonds issued in an exchange or transfer of Bonds will be delivered to the registered owner or assignee of the registered owner in not more than three business days after the receipt of the Bonds to be canceled, and the written instrument of transfer or request for exchange duly executed by the registered owner or his duly authorized agent, in form satisfactory to the Trustee. New Bonds registered and delivered in an exchange or transfer shall be in any integral multiple of \$5,000 for any one maturity and for a like aggregate principal amount as the Bonds surrendered for exchange or transfer. See "Book-Entry-Only System" herein for a description of the system to be utilized initially in regard to ownership and transferability of the Bonds. Neither the Authority nor the Trustee shall be required to transfer or exchange any Bond called for redemption (i) during the period commencing with the close of business on any Record Date and ending with the opening of business on the next following principal or interest payment date, or by (ii) with respect to any bond or portion thereof called for redemption within 45 days of the date fixed for redemption.

RECORD DATE FOR INTEREST PAYMENT . . . The record date ("Record Date") for the interest payable on the Bonds on any interest payment date means the 15th calendar day of the immediately preceding month.

BONDHOLDERS' REMEDIES . . . If an Event of Default shall occur and be continuing, then, in addition to all of the other rights and remedies granted to the Trustee under the Indenture, subject to the provisions of the Indenture, may proceed to protect and enforce its rights and the rights of the Owners of Bonds by suit, action or proceeding in equity or at law or otherwise, whether for the specific performance of any covenant or agreement contained in the Indenture or any supplemental indenture or in aid of the execution of any power granted in the Indenture or for the enforcement of any other legal, equitable or other remedy, as the Trustee, being advised by counsel, shall deem most effectual to protect and enforce any of the rights of the Trustee or such Owners of the Bonds, Notes or Obligations, including, without limitation, the right to seek a writ of mandamus issued by a court of competent jurisdiction compelling the members of the Board or other officers of the Authority to make payment of the Pledged Revenues (but only from and to the extent of the sources provided in the Indenture or any supplemental indenture) or to observe and perform such covenant, obligations or conditions of the Indenture or any supplemental indenture. Acceleration is not a remedy available to the Trustee under the terms of the Indenture.

Furthermore, the Authority is eligible to seek relief from its creditors under Chapter 9 of the U.S. Bankruptcy Code ("Chapter 9"). Although Chapter 9 provides for the recognition of a security interest represented by a specifically pledged source of revenues (such as the Pledged Revenues), such provision is subject to judicial construction. Chapter 9 also includes an automatic stay provision that would prohibit, without Bankruptcy Court approval, the prosecution of any other legal action by creditors or bondholders of an entity which has sought protection under Chapter 9. Therefore, should the Authority avail itself of Chapter 9 protection from creditors, the ability to enforce would be subject to the approval of the Bankruptcy Court (which could require that the action be heard in Bankruptcy Court instead of other federal or state court); and the Bankruptcy Code provides for broad discretionary powers of a Bankruptcy Court in administering any proceeding brought before it. The opinion of Bond Counsel will note with respect to the Bonds that all opinions relative to the enforceability of the Indenture and the Bonds are qualified with respect to the customary rights of debtors relative to their creditors and to general principals of equity that permit the exercise of judicial discretion.

No remedy conferred upon or reserved to the Trustee under the Indenture is intended to be exclusive of any other available remedy or remedies, but each and every such remedy shall be cumulative and shall be in addition to every other remedy given under the Indenture, or now or hereafter existing at law or in equity or by statute. No delay or omission to exercise any right or power accruing upon any default shall impair any such right or power or shall be construed to be a waiver of any such default or acquiescence therein, and every such right and power may be exercised from time to time and as often as may be deemed expedient.

BOND INSURANCE

BOND INSURANCE POLICY

Concurrently with the issuance of the Bonds, Build America Mutual Assurance Company ("BAM") will issue its Municipal Bond Insurance Policy for the Bonds (the "Policy"). The Policy guarantees the scheduled payment of principal of and interest on the Bonds when due as set forth in the form of the Policy included as an exhibit to this Official Statement.

The Policy is not covered by any insurance security or guaranty fund established under New York, California, Connecticut or Florida insurance law.

BUILD AMERICA MUTUAL ASSURANCE COMPANY

BAM is a New York domiciled mutual insurance corporation. BAM provides credit enhancement products solely to issuers in the U.S. public finance markets. BAM will only insure obligations of states, political subdivisions, integral parts of states or political subdivisions or entities otherwise eligible for the exclusion of income under section 115 of the U.S. Internal Revenue Code of 1986, as amended. No member of BAM is liable for the obligations of BAM.

The address of the principal executive offices of BAM is: 200 Liberty Street, 27th Floor, New York, New York 10281, its telephone number is: 212-235-2500, and its website is located at: www.buildamerica.com.

BAM is licensed and subject to regulation as a financial guaranty insurance corporation under the laws of the State of New York and in particular Articles 41 and 69 of the New York Insurance Law.

BAM's financial strength is rated "AA/Stable" by S&P Global Ratings, a business unit of Standard & Poor's Financial Services LLC ("S&P"). An explanation of the significance of the rating and current reports may be obtained from S&P at www.standardandpoors.com. The rating of BAM should be evaluated independently. The rating reflects the S&P's current assessment of the creditworthiness of BAM and its ability to pay claims on its policies of insurance. The above rating is not a recommendation to buy, sell or hold the Bonds, and such rating is subject to revision or withdrawal at any time by S&P, including withdrawal initiated at the request of BAM in its sole discretion. Any downward revision or withdrawal of the above rating may have an adverse effect on the market price of the Bonds. BAM only guarantees scheduled principal and scheduled interest payments payable by the issuer of the Bonds on the date(s) when such amounts were initially scheduled to become due and payable (subject to and in accordance with the terms of the Policy), and BAM does not guarantee the market price or liquidity of the Bonds, nor does it guarantee that the rating on the Bonds will not be revised or withdrawn.

Capitalization of BAM

BAM's total admitted assets, total liabilities, and total capital and surplus, as of December 31, 2016 and as prepared in accordance with statutory accounting practices prescribed or permitted by the New York State Department of Financial Services were \$496.7 million, \$65.2 million and \$431.5 million, respectively.

BAM is party to a first loss reinsurance treaty that provides first loss protection up to a maximum of 15% of the par amount outstanding for each policy issued by BAM, subject to certain limitations and restrictions.

BAM's most recent Statutory Annual Statement, which has been filed with the New York State Insurance Department and posted on BAM's website at www.buildamerica.com, is incorporated herein by reference and may be obtained, without charge, upon request to BAM at its address provided above (Attention: Finance Department). Future financial statements will similarly be made available when published.

BAM makes no representation regarding the Bonds or the advisability of investing in the Bonds. In addition, BAM has not independently verified, makes no representation regarding, and does not accept any responsibility for the accuracy or completeness of this Official Statement or any information or disclosure contained herein, or omitted herefrom, other than with respect to the accuracy of the information regarding BAM, supplied by BAM and presented under the heading "BOND INSURANCE".

Additional Information Available from BAM

Credit Insights Videos. For certain BAM-insured issues, BAM produces and posts a brief Credit Insights video that provides a discussion of the obligor and some of the key factors BAM's analysts and credit committee considered when approving the credit for insurance. The Credit Insights videos are easily accessible on BAM's website at buildamerica.com/creditsights/. (The preceding website address is provided for convenience of reference only. Information available at such address is not incorporated herein by reference.)

Credit Profiles. Prior to the pricing of bonds that BAM has been selected to insure, BAM may prepare a pre-sale Credit Profile for those bonds. These pre-sale Credit Profiles provide information about the sector designation (e.g. general obligation, sales tax); a preliminary summary of financial information and key ratios; and demographic and economic data relevant to the obligor, if available. Subsequent to closing, for any offering that includes bonds insured by BAM, any pre-sale Credit Profile will be updated and superseded by a final Credit Profile to include information about the gross par insured by CUSIP, maturity and coupon. BAM pre-sale and final Credit Profiles are easily accessible on BAM's website at buildamerica.com/obligor/. BAM will produce a Credit Profile for all bonds insured by BAM, whether or not a pre-sale Credit Profile has been prepared for such bonds. (The preceding website address is provided for convenience of reference only. Information available at such address is not incorporated herein by reference.)

Disclaimers. The Credit Profiles and the Credit Insights videos and the information contained therein are not recommendations to purchase, hold or sell securities or to make any investment decisions. Credit-related and other analyses and statements in the Credit Profiles and the Credit Insights videos are statements of opinion as of the date expressed, and BAM assumes no responsibility to update the content of such material. The Credit Profiles and Credit Insight videos are prepared by BAM; they have not been reviewed or approved by the issuer or the underwriter for the Bonds, and the issuer and underwriter assume no responsibility for their content.

BAM receives compensation (an insurance premium) for the insurance that it is providing with respect to the Bonds. Neither BAM nor any affiliate of BAM has purchased, or committed to purchase, any of the Bonds, whether at the initial offering or otherwise.

BOND INSURANCE GENERAL RISK FACTORS

In the event of default of the scheduled payment of principal or interest on the Bonds when all or a portion thereof becomes due, the Trustee on behalf of the owners of the Bonds shall have a claim under the Policy for such payments. The payment of principal and interest in connection with mandatory or optional prepayment of the Bonds by the Authority which is recovered by the Authority from the Beneficial Owners as a voidable preference under applicable bankruptcy law is covered by the Policy; however, such payments will be made by the Insurer at such time and in such amounts as would have been due absent such prepayment by the Authority (unless the Insurer chooses to pay such amounts at an earlier date).

Payment of principal or interest on the Bonds is not subject to acceleration, but other legal remedies upon the occurrence of non-payment do exist (see "THE BONDS – Bondholders' Remedies"). The Insurer may direct the pursuit of available remedies, and generally must consent to any remedies available to and requested by the Beneficial Owners. In the event the Insurer is unable to make payment of principal and interest as such payments become due under the Policy, the Bonds are payable solely from and equally and ratably secured, together with the currently outstanding Previously Issued Bonds issued by the Authority, by a first and prior lien on and pledge of the Trust Estate. In the event the Insurer becomes obligated to make payments with respect to the Bonds, no assurance is given that such event will not adversely affect the market price or the marketability (liquidity) of the Bonds.

The long-term rating on the Bonds will be dependent on the financial strength of the Insurer and its claims paying ability. The Insurer's financial strength and claims paying ability are predicated upon a number of factors which could change over time. No assurance can be given that the long-term ratings of the Insurer and of the rating on the Bonds, whether or not subject to the Policy, will not be subject to downgrade and such event could adversely affect the market price or the marketability (liquidity) for the Bonds. See the disclosure described in "OTHER INFORMATION – Ratings" herein.

The obligations of the Insurer under the Policy are unsecured obligations of the Insurer and in an event of default by the Insurer; the remedies available may be limited by applicable bankruptcy law. Neither the Authority, the Underwriter, nor its Financial Advisor has made an independent investigation into the claims paying ability of the Insurer and no assurance or representation regarding the financial strength or projected financial strength of the Insurer is given.

The Indenture provides that any Bond will be deemed paid and will no longer be considered to be outstanding within the meaning of the Indenture when payment of principal of and interest on such Bond to its maturity has been made or provided for. Payment may be provided for by deposit of any combination of (1) money in an amount sufficient to make such payment and/or (2) Government Securities. Any such deposit must be certified by an independent public accountant to be of such maturities and interest payment dates and bear such interest as will, without reinvestment, be sufficient to make the payment to be provided for on the Bond; provided, however, that no certification by an independent accounting firm of the sufficiency of deposits shall be required in connection with a gross defeasance of Bonds. The Indenture provides that "Government Securities" means (A) direct, noncallable obligations of the United States of America, including obligations that are unconditionally guaranteed by the United States of America. There is no assurance that the ratings for U.S. Treasury securities acquired to defease any Bonds, or those for any other Investment Securities, will be maintained at any particular rating category. Further, there is no assurance that current Texas law will not be amended in a manner that expands or contracts the list of permissible defeasance securities (such list consisting of those securities identified in clauses (A) through (C) above), or any rating requirement thereon, that may be purchased with defeasance proceeds relating to the Bonds ("Defeasance Proceeds"), though the Authority has reserved the right to utilize any additional securities for such purpose in the event the aforementioned list is expanded. Because the Indenture does not contractually limit such permissible defeasance securities and expressly recognizes the ability of the Authority to use lawfully available Defeasance Proceeds to defease all or any portion of the Bonds, registered owners of Bonds are deemed to have consented to the use of Defeasance Proceeds to purchase such other defeasance securities, notwithstanding the fact that such defeasance securities may not be of the same investment quality as those currently identified under Texas law as permissible defeasance securities.

Upon such deposit as described above, such Bonds will no longer be regarded to be outstanding obligations for any purpose, including the application of any limitation on indebtedness. After firm banking and financial arrangements for the discharge and final payment of the Bonds have been made as described above, all rights of the Authority to take any action amending the terms of the Bonds is extinguished.

DEBT SERVICE RESERVE FUND SURETY BOND

BAM has made a commitment to issue a financial guaranty surety policy for the Debt Service Reserve Fund with respect to the Series 2017 Bonds (the "Reserve Fund Surety Policy"), effective as of the date of issuance of the Series 2017 Bonds. Under the terms of the Reserve Fund Surety Policy, BAM will unconditionally and irrevocably guarantee to pay that portion of the scheduled principal and interest on the Series 2017 Bonds that becomes due for payment but shall be unpaid by reason of nonpayment by the Authority (the "Insured Payments").

BAM will pay each portion of an Insured Payment that is due for payment and unpaid by reason of nonpayment by the Authority to the Trustee, as beneficiary of the Reserve Fund Surety Policy on behalf of the holders of the Series 2017 Bonds on the later to occur of (i) the date such scheduled principal or interest becomes due for payment or (ii) the business day next following the day on which BAM receives a demand for payment therefore in accordance with the terms of the Reserve Fund Surety Policy.

No payment shall be made under the Reserve Fund Surety Policy in excess of \$897,639.09, which amount is equal to the average annual debt service requirements on the Series 2017 Bonds (the "Reserve Fund Surety Policy Limit"). Pursuant to the terms of the Reserve Fund Surety Policy, the amount available at any particular time to be paid to the Paying Agent/Registrar shall automatically be reduced to the extent of any payment made by BAM under the Reserve Fund Surety Policy, provided, that, to the extent of the reimbursement of such payment to BAM the amount available under the Reserve Fund Surety Policy shall be reinstated in full or in part, in an amount not to exceed the Reserve Fund Surety Policy Limit.

The Reserve Fund Surety Policy does not insure against nonpayment caused by the insolvency or negligence of the Trustee.

THE AUTHORITY AND THE WATER SUPPLY CONTRACTS

THE AUTHORITY

The Authority is a conservation and reclamation district created pursuant to Article XVI, Section 59, of the Texas Constitution and Tex. Laws, 1981, 67th Legislature Regular Session, Chapter 511 (the "Act"). The Act authorizes the Authority to perform any act consistent with the powers enumerated in the Act, including the ability to issue bonds and notes to carry out its purpose. Pursuant to the Act and bylaws of the Authority, all powers of the Authority shall be exercised by a Board of Directors (the "Board" or "Directors" as applicable). Such Directors shall be appointed and removed by a majority vote of the governing body of each of the cities and districts comprising the Authority. A single Director shall be appointed from each city and each district comprising the Authority.

The Authority is comprised of all of the territory contained within the City of Brownsville, Texas, the City of Los Fresnos, Texas, the Town of Indian Lake, Texas; Brownsville Navigation District of Cameron County, Laguna Madre Water District (formerly, Cameron County Fresh Water Supply District No. 1), and Valley Municipal Utility District No. 2 of Cameron County, Texas. The Authority's territory is subject to expansion should boundaries of any of said cities or districts increase through annexation.

Other territory in Cameron County, Texas may be included in the Authority by the filing of a petition with the Board praying for inclusion of an incorporated city or duly created district organized pursuant to Article XVI Section 59, of the Texas Constitution, as amended. If the petition of a district located within or partially within the extraterritorial jurisdiction of a city, as such terms are defined in Chapter 42, Texas Local Government Code as amended, is to be considered by the Board, it must first be approved by a majority vote of the governing body of such city.

If the Board finds that the petition complies with the statutory requisites, that the inclusion would be in the interest of the territory and the Authority, and that the Authority will be able to supply water to the territory, the Board may adopt a resolution stating the conditions, if any, under which territory may be included in the Authority. In addition, the Board must adopt a resolution declaring its intention to hold a public hearing in the territory for the purpose of determining whether the territory will be benefited by the improvements, works, and facilities then owned or operated or contemplated to be owned or operated by the Authority. If, at the conclusion of the hearing, the Board finds that all of the lands in such territory will be benefited by the present or contemplated improvement, works, or facilities of the Authority, the Board will enter an order including said territory in the Authority, making the inclusion incontestable. No land has been added to the Authority by petition.

Likewise, any city or district included in the Authority may remove itself from the Authority by majority vote of the governing body of such city or district; however, so long as a city or district is obligated by contract, such as the Water Supply Contracts, to make payments to the Authority, such city or district shall not have the right to remove itself from the Authority. No city or district within the Authority has asked to be removed or has been removed from the Authority.

The directors of the Board (the "Directors") are appointed and removed by a majority vote of the governing body of each of the cities and districts comprising the Authority; provided, that with respect to any such city having its waterworks managed by a Board of Trustees appointed by its governing body, the Director chosen to represent such city shall be chosen by the majority vote of such Board of Trustees. A single Director is appointed from each city and each district comprising the Authority.

Each city and district listed appoints one Director each second year after May 31, 1983. The governing body of each such city (or the Board of Trustees as aforementioned) and district appoints a Director for a two-year term beginning June 1 of that year to fill the vacancies caused by expiring terms. The initial Director for any city or district after May 31, 1983, may be appointed for a term ending on the first May 31st occurring in an odd-numbered year no more than two years from the date of the appointment.

Each Director serves the term of office until a successor is appointed and qualified. No person may be appointed a Director unless he resides in and owns taxable property in the city or the district from which he is appointed. A Director must be a member of a governing body of a city or a district; provided, that with respect to any such city having its waterworks managed by a Board of Trustees appointed by its governing body, the Director chosen to represent such city must be a member of such Board of Trustees. No employee of a city or a district can be appointed as Director.

Such Directors must subscribe the constitutional oath of office, and each shall give bond for the faithful performance of his duties in the amount of \$5,000, the cost of which shall be paid by the Authority.

The Directors having a majority in interest constitute a quorum of the Board. A vote of the Directors having the majority in interest is necessary to pass on any question before the Board. In determining a majority in interest, each Director is accorded a percentage of interest in proportion to the amount of potable water the city or district he represents received during the preceding calendar year from the Authority relative to what the contract bears to the total potable water received by all cities and districts comprising the Authority from the Authority pursuant to contract during such period. Any Director or Directors accorded an aggregate percentage in excess of 50 percent has a majority of interest. Currently, BPUB has the majority in interest pursuant to the Authority's enabling legislation.

The Board must elect from its members a president and a vice-president of the Authority and such other officers as in the judgment of the Board are necessary. The president is the chief executive officer of the Authority and the presiding officer of the Board and has the same right to vote as any other Director. The Board shall also appoint a secretary and a treasurer who may or may not be members of the Board, and it may combine such offices. The treasurer is required to give bond in such amount as may be required by the Board, but in no event less than \$100,000. Until the Authority has authorized the issuance of bonds, the amount of the official bond of the treasurer may be fixed by the Board in any amount not less than \$5,000.

The Board has authority to employ a general manager and consulting engineers, financial consultants, attorneys, and auditors.

The Authority is authorized to purchase, construct, acquire, own, lease, operate, maintain, repair, improve, and extend inside and outside its boundaries, at any location whatsoever, in the sole discretion of the Authority, land and interest in land, any and all works, improvements, facilities, plants, equipment, and appliances incident, helpful, or necessary to provide for the control, storage, preservation, transmission, treatment, and distribution and use of sea water, storm water and flood water, the water of rivers and streams, and underground water for municipal, domestic, industrial, and other beneficial uses.

The Act grants the Authority the right to acquire land and easements within and without the Authority (including land above the probable high water line around any impounding or diversion reservoir) by condemnation in the manner provided by Chapter 21, Texas Property Code, relating to eminent domain, but the Authority may condemn only an easement. The Authority is considered to be a municipal corporation within the meaning of Chapter 21, Texas Property Code, as amended.

The Act confers upon the Authority the power to issue revenue bonds and notes from time to time in one or more issues or series to be payable from and secured by liens on and pledges of all or any part of any of the revenues, income, or receipts derived by the Authority from its ownership, operation, lease, or sale of any property, buildings, structures, or facilities, including the proceeds or revenues from contracts with any city, district, public agency, or other political subdivision. Such bonds and notes may be issued to mature serially or otherwise within not to exceed 50 years from their date, and provision may be made for the subsequent issuance of additional parity bonds and notes, or subordinate lien bonds or notes, under any terms or conditions that may be set forth in the resolution authorizing the issuance of the bonds or notes. Such bonds and notes, and any interest coupons appertaining thereto, are and shall constitute negotiable instruments within the meaning and for all purposes of the Uniform Commercial Code, Section 1.01 et seq., Business & Commerce Code, provided that the bonds and notes may be issued in such form, denominations, and manner, and under such terms, conditions, and details, and may be sold in such manner, at such price, and under such terms, and said bonds and notes shall bear interest at such rates not exceeding 15 percent per annum, all as shall be determined and provided in the resolution authorizing the issuance of the bonds. If so provided in the bond or resolution, the proceeds from the sale of the bonds or notes may be used for paying interest on the bonds or notes during the period of the acquisition or construction of any facilities to be provided through the issuance of the bonds or notes, for paying expenses of operation and maintenance of facilities, for creating a reserve fund for the payment of the principal of and interest on the bonds or notes, and for creating any other funds, and such proceeds may be placed on time deposit or invested, until needed, and all to the extent and in the manner provided in the resolution. The Authority may pledge all or any part of its revenues, income, or receipts from fees, rentals, rates, charges, and contract proceeds or payments to the payment of the bonds or notes, including the payment of principal, interest and any other amounts required or permitted in connection with the bonds or notes. The pledged fees, rentals, rates, charges, proceeds, or payments shall be fixed and collected in amounts that will be at least sufficient, together with any other pledged resources, to provide for all payments of principal, interest and any other amounts required in connection with the bonds or notes, and to the extent required by the resolution authorizing the issuance of the bonds or notes, to provide for the payment of expenses in connection with the bonds or notes and operation, maintenance, and other expenses in connection with the aforesaid facilities. Said bonds and notes may be additionally secured by mortgages or deeds of trust on any real property owned or to be acquired by the Authority and by liens on any personal property appurtenant to such real property; and the Board may authorize the execution of trust indentures, mortgages, deeds of trust, or other forms of encumbrances to evidence same. Also, the Authority may pledge to the payment of the bonds and notes all or any part of any grant, donation, revenues, or income received or to be received from the United States government or any other public or private source, whether pursuant to an agreement or otherwise.

The Authority is authorized to enter into contracts with the State of Texas, cities and districts organized pursuant to Article XVI, Section 59, of the Texas Constitution, as amended, and others for supplying water to them. The Authority is also authorized to contract with any city, district, or other person for the rental or leasing of or for the operation of the water production, water supply, water filtration or purification, and water supply facilities of such city, such district, or other person upon such consideration as the Authority and the city, the district, or other persons may agree. Any such contract may be upon such terms and for such time as the parties may agree, and it may provide that it shall continue in effect until bonds or notes specified therein and refunding bonds issued in lieu of such bonds are paid. All such cities and districts are authorized to enter into such contracts with the Authority and to fix, charge, and collect fees, rates, charges, rentals, and other amounts for any service or facilities provided pursuant to or in connection with any contract with this Authority, and to pledge such amounts sufficient to make all payments required under the contract.

WATER SUPPLY CONTRACTS

The Authority and each of the Participating Customers have entered into Water Supply Contracts as of December 1, 2002 (the "Original Contract Date") as amended by the First Amendment dated as of November 1, 2009 (the "First Amendment") and as amended by the Second Amendment dated as of July 1, 2012 (collectively, the "Water Supply Contracts"). Each Water Supply Contract shall remain in effect for a period of 30 years following the Original Contract Date or until all of the Previously Issued Bonds, the Bonds, and any additional bonds have been paid off or provision is made for their payment. Pursuant to the Water Supply Contracts, the Participating Customers have unconditionally agreed to pay to the Authority, as maintenance and operations expenses from the gross revenues of their respective utility systems, such sums as are required to pay (1) operations and maintenance expenses incurred by the Authority with respect to the Project, (2) Debt Service Payments on all Bonds, Notes and Obligations issued under the Indenture, which shall include the payment of principal, redemption premium, if any, and interest on the Bonds, (3) all amounts required to establish, restore and maintain an amount equal to the Reserve Fund Requirement in the Debt Service Reserve Fund, (4) all other debt service obligation expenses, and (5) a separate operations and maintenance reserve fund which is to be used for certain operation and maintenance expenses of the System. Such payments are an unconditional obligation of the Participating Customers and are payable regardless of whether or not the Project is completed, operable, operated or retired and notwithstanding the suspension, interruption, interference, reduction or curtailment of operation of the Project or the delivery of treated water, regardless of the cause or origin thereof. Such payments are not subject to any reduction, whether offset or otherwise, and are not conditional upon performance by the Authority under the Water Supply Contracts, or any other lease, agreement or other obligation of the Authority. See "APPENDIX C – Southmost Regional Water Authority Water Supply Contract."

Under the Water Supply Contracts, the Participating Customers have covenanted to make their pro-rata payments toward the Debt Service on the Previously Issued Bonds, the Bonds and the operations and maintenance expenses of the Authority and these payments are unconditional without right of set-off, but the Participating Customers' contractual obligations are not otherwise secured by assigned collateral, revenues or other assets of the Participating Customers. The Authority has not undertaken an independent investigation of any Participating Customers' financial ability to meet its contractual obligation under the Water Supply Contracts.

The Indenture affords the Authority no specific legal remedy upon default by one or more of the Participating Customers. Upon default by a Participating Customer, the Authority may be required to sue the Participating Customer for payment of its pro-rata share, which may be difficult, time consuming and expensive. Even if a judgment were to be issued against a Participating Customer for non-payment, the collection of that judgment would itself be difficult, time consuming and expensive, and would be subject to the bankruptcy laws (see “THE BONDS - Bondholder’s Remedies” herein), and would never be payable from any of the Participating Customers’ ad valorem tax revenues.

THE PROJECT

INTRODUCTION . . . The Southmost Regional Water Authority was created in 1981 for the purpose of developing alternative water supply strategies for the member entities. The Authority was dormant until activated by its entities in 2000 to study the possibility of using brackish water as an alternative to the limited supply from the Rio Grande River. The Authority has been active since the determination that using brackish water was feasible and the issuance of bonds in 2002.

The Authority determined that there is an economically feasible source of brackish ground water that can be treated to supplement the current source of the Rio Grande water. Key elements in the determination of its viability include:

- Source of groundwater is independent of the Rio Grande flows.
- Treatment of brackish ground water is competitive with the treatment of surface water.
- A savings of the cost of acquiring water rights from the Rio Grande River.
- Water quality is enhanced through the reverse osmosis treatment.

The Authority realized the importance of establishing a regional approach to the water supply issues of the area. By joining together, the member entities enjoy the cost savings attributed to the economies of scale realized of a larger regional treatment facility. In the operations, only one set of personnel is required as opposed to separate operation costs that would be required if each Participating Customer built and operated its own treatment plant. The Authority relies on the power provided by the Public Utilities Board of the City of Brownsville, Texas (“BPUB”).

PROJECT PARTNERS . . . Member entities that have approved the Water Supply Contract include the BPUB, Brownsville Navigation District (“BND”), Valley Municipal Utility District No. 2 (“VMUD”), the City of Los Fresnos, Texas and the Town of Indian Lake, Texas.

SERVICE AREA AND DEMAND . . . The service area of the member entities extends from the Rio Grande on the South, to the Port of Brownsville on the East, to VMUD on the West, and to Los Fresnos and Indian Lake on the North. The area’s Certificates of Convenience and Necessity (CCN) cover 190 square miles and a population of approximately 196,000 people in the incorporated cities and rural areas served.

Each Participating Customer has a demand for additional treated water. Because of this need, each Participating Customer was receptive to the regional approach of developing treated water capabilities. A preliminary feasibility study indicated that it was more cost effective to join the Authority with a joint treatment project rather than to develop and expand their own treatment facilities.

Since the brackish groundwater supply from the Authority serves as a supplemental supply to the Participating Customers, each Participating Customer contracted for the available right to their proportionate share of water. Therefore, no demographic or water demand projections for known or future customers are included herein.

INITIAL PROJECT . . . The initial phase of the Project is complete and has been operational since 2004. The initial phase of the Project is providing 7.5 MGD of treated water to the Participating Customers. The initial phase of the Project consists of a wellfield, consisting of wells producing brackish groundwater, together with interests in property relating to the well sites and access, power line and water line easements to each well site, a brackish water collection system and transmission main that gathers the water produced by the wells for transport to the water treatment plant, a water treatment plant, and storage tanks, pumps, and lines to deliver the treated water.

The first phase of the project has provided 7.5 MGD of treated water capacity to the Participating Customers. This is limited to the availability of brackish well water in the study area. It is expected that subsequent development of the well field will yield additional supply. This will be determined upon the data development of the aquifer characteristics during continuous pumping.

Allocation of water is based upon annual water sales for each Participating Customer. The table below shows the allocation for each Participating Customer.

Participating Customer	Allocated Portion
Public Utilities Board of the City of Brownsville, Texas	92.91%
Valley Municipal Utility District #2	2.51%
City of Los Fresnos	2.28%
Brownsville Navigation District	2.10%
Town of Indian Lake	0.20%

GROUNDWATER AVAILABILITY . . . Planning for and installation of the well field was based on the Authority's groundwater availability assessment and planning studies prepared by R.W. Harden & Associates. The studies indicated that favorable conditions exist for the development of at least 16 million gallons per day ("MGD") of brackish groundwater from the well field located west of Brownsville. Water quality characteristics of produced water from the targeted aquifer zones were shown to meet long-term desalinization project needs of less than 5,000 milligrams per liter (mg/L) total dissolved solids ("TDS"). The studies described herein includes compilation and review of previous studies, test drilling and aquifer testing conducted for this availability determination, computer modeling to determine the availability of up to 16 MGD from the aquifer, conceptual well field design, and well field construction and maintenance cost estimates.

Based on groundwater quality and quantity, the most suitable aquifer for development in the Brownsville area is the alluvium associated with the Rio Grande. The Rio Grande Alluvium is about 350 feet thick in the study area and consists of complexly interbedded sand, silt, clay, and gravel. In general, permeable materials (coarse sand and gravel) are confined to two zones within the Alluvium. To the west and south of the study area, along the Rio Grande, the most permeable materials have been found between 100 to 200 feet below ground level (bgl) in what previous studies have designated the Primary Zone (Harden, 1990). This evaluation has shown that in the current study area northwest of Brownsville, the Secondary Zone (between about 210 and 300 feet bgl) contains sand and gravel beds that are more laterally continuous and more productive than those in the Primary Zone. Because of the nature of the environment in which these sediments were deposited, the more permeable water producing sands and gravels are typically erratic in occurrence, and the ability to predict the subsurface location and geometry of these permeable materials requires detailed test drilling.

The test drilling and aquifer testing program conducted for the evaluation of the well field included test holes, test well installation, water quality sampling, short-term aquifer testing of test wells, construction of a pilot production well, and a 28-day, 800 gallon per minute aquifer test. The results of the testing program indicated that the Secondary Zone had an average transmissivity of about 70,000 gallons per day per foot (gpd/ft) in the area of the well field. The testing program also had shown that, where coarse sand and gravel exist in the Primary Zone, the transmissivity of the Primary Zone is about 40,000 gpd/ft.

Computer simulations indicated that a well field capable of producing at least 16 mgd for 30 years or more is feasible from the Secondary Zone and is based on several conservative assumptions about the nature of the aquifer. While a well field production of up to 20 mgd may be possible, proving up such a production rate requires further test drilling and/or long-term monitoring of the 16 mgd well field. Additional production could possibly be acquired by increasing pump capacities in existing wells, developing the Primary Zone, developing brackish groundwater supplies in the underlying Beaumont/Lissie Formations, or through the lateral expansion of the Secondary Zone well field.

Based on the studies, the following was concluded:

1. Given the level of knowledge of the hydrogeology in the area of investigation, the well field is capable of producing 16 mgd for 30 years or more and could be completed in the Rio Grande Alluvium in the study area northwest of Brownsville.
2. Long-term groundwater availability is partially dependent on the current and future groundwater production from others. Such future projections of competitive pumpage are difficult to estimate, but some consideration was included in this analysis for such an occurrence.
3. Predictions of long-term water quality indicated by the model were highly dependent on well location. Model results indicate that TDS concentrations for individual wells in the well field could likely vary from 2,000 to 4,000 mg/L. The expected water quality produced from the well field described herein will likely be between 2,000 and 3,000 mg/L TDS and not significantly increase over the life of the project. This is well within the water quality criteria required for the project.
4. Computer modeling indicated that a well field production rate of 20 mgd for 30 years could be possible, but assumptions and calculations indicate such should not be considered without additional and more detailed data pertaining to site specific conditions over a larger area and the long-term hydraulic characteristics of the aquifer. Future development could potentially occur through increasing production from the Secondary Zone or drilling additional wells in shallower or deeper zones within the area of this well field.
5. While the report provided a foundation for the groundwater development, it was based on several assumptions that may affect actual project costs and long-term availability. These include assumptions about the regional nature of the aquifer and projected pumpage in the aquifer by others.

Water quality from the well field is likely to continue to average about 3,000 mg/L TDS throughout the project life. Based on computer simulations, it is likely that only slight water quality deterioration will occur as pumping continues through time. Throughout the 30-year study period, data and analyses indicate that water quality will be below the 5,000 mg/L TDS required for desalinization purposes for this project.

Operational personnel monitor operation of the wells and operational data support the findings of the groundwater study and modeling. The wells provide a reliable source with consistent water quality, averaging 3,600 mg/L TDS. The report "Availability of Brackish Groundwater from the Rio Grande Alluvium, Cameron County, Texas", by R.W. Harden & Associates regarding the availability of the groundwater in the study area was used for the report. A copy of the report is available from the Authority.

Under state law, surface owners of lands over the reservoir may produce water from the reservoir at will. As other surface owners exercise their right to produce this water, the overall cost to the Authority to produce water may increase substantially.

WELL FIELD . . . The well field is located west of the Town of Rancho Viejo. Expressway 77/83 bounds it on the North and South by FM 1732 and on the West by Cameron County District No 20 Main Canal. This area is currently used mostly as agricultural land. There are a few random residential houses on 1 to 10 acre tracts in this area. The well field consists of 20 wells spaced 1,500 to 2,500 feet apart, and producing 330 to 450 gallons per minute (gpm) from 17 wells and 800 to 900 gallons per minute (gpm) from 3 wells. Current capacity from all 20 wells is 13 MGD. The wells are equipped with submersible pumps and brick enclosures provide protection for the pumping equipment at each well site. The pump and down hole accessories are stainless steel to deal with the corrosiveness of the brackish water. Annual operation and maintenance costs for the well field are approximately \$575,000, with electrical costs providing the greater part of these costs.

BRACKISH WATER TRANSMISSION . . . The brackish water transmission line includes a 30 inch PVC line. It begins at the well field and proceeds north to cross the Expressway 77/83 and proceeds south along the expressway to highway FM 511 and terminates at the plant site. It is approximately 7.2 miles in length. The ultimate capacity of this transmission line will be 17 MGD, which will allow for double supply capacity from the well field.

DESCRIPTION OF SITE AND SURROUNDING AREA . . . The brackish water treatment plant is built on 17 acres located on FM 511 approximately 1.3 miles west of Paredes line Road (FM 1847). This area is on the north side of the City of Brownsville, Texas (“Brownsville”) and centrally located to all the Participating Customers. The plant site is adjacent to the drainage ditch of Cameron County Drainage District No. 1. The plant discharges concentrate water into the drainage ditch, in accordance with permits issued under federal and state law. This plant site is in flood map plan designation Class “C” area, which is outside of the flood plan.

REVERSE OSMOSIS TREATMENT PLANT. . . NRS Engineers provided engineering design and construction management for the reverse osmosis (RO) water treatment system and well field. The RO process had an original permeate water capacity of 6.0 MGD with a blended plant capacity of 7.5 MGD. The well water quality is high in total dissolved solids and chlorides. However, the project is able to treat the water to “bottled water” quality, consistently meeting all drinking water standards. A major factor considered in the design of the RO process is the future expansion requirement. The process accommodates the expected future total permeate water capacity of 10 MGD and a blended total capacity of 12.5 MGD. The pre-treatment and post treatment components and building were designed to accommodate the increase in flow requirements.

MICROFILTRATION PRETREATMENT. . . In 2015, the Authority completed an expansion to provide microfiltration pretreatment and a total blended production capacity of 10 MGD. The purpose of the microfiltration expansion is to add microfiltration membrane pretreatment to reduce arsenic and iron levels in the groundwater prior to treatment through reverse osmosis (RO) membrane desalination. The expansion has resulted to be beneficial in several ways including: 1) lowering the arsenic and iron concentration to allow higher production levels; 2) extending the life of RO membranes cleaning cycles of RO membranes; 3) reducing the amount of chemicals required to stabilize RO water after treatment; and 4) increasing capacity from 7.5 MGD to 10 MGD blended.

Additional pretreatment consists of scale inhibitor addition for salts scale control and cartridge filtration for removal of particulate matter. Post-treatment process consists of pH adjustment using caustic soda, addition of calcium chloride for water stabilization, and chloramines (chlorine with ammonium sulfate) for disinfection. This process allows the finished water to meet regulatory guidelines.

Blending of well water from the well field with the permeate from the proposed reverse osmosis system provides for flexibility of product water quality. The RO permeate water can be blended with approximately 2.0 MGD of the well water from the well field. The blending capability reduces chemical costs and reduces the corrosivity of the finished product water. The product is stored for further delivery into the distribution system. A 7.5 million gallon aboveground storage tank provides on-site storage of product water.

A 16” concentrate line discharging to an existing drainage ditch provides safe and economical concentrate disposal. Subsequent studies conducted by a community college show that the concentrate disposal is providing ecological benefits to the shallow-water coastal estuaries.

CONCENTRATE DISCHARGE PERMIT . . . A discharge permit has been issued by the Texas Commission on Environmental Quality (“TCEQ”) for the disposal of RO concentrate. The permit requires the Authority to regularly monitor conductivity, pH, and flow. The Authority has met all requirements provided in the discharge permit. Additionally, preliminary findings demonstrate that the flows have ecological benefits to the area.

DRILLING AND PRODUCTION PERMIT . . . No groundwater conservation district is located within Cameron County, where the well field is located, so no permits were required prior to drilling the wells or producing the water. While there is no known effort to do so, under state law, a groundwater conservation district with authority to regulate production of groundwater could be created within Cameron County.

ANTIQUITIES PERMIT . . . The Authority prepared an archeological study to determine impact in construction areas. The report, which showed no impact, was submitted and approved by the Texas Historical Commission.

ENDANGERED SPECIES IMPACT . . . The Authority prepared a report after a field review of project sites and determined no impact on endangered species. The Project area is a potential habitat for certain endangered and threatened species. Under federal law, the Authority assured that its contractors take all necessary measure to avoid harm to any and all endangered or threatened species and their habitat. The Authority imposed certain obligations upon contractors to educate their construction personnel regarding federal law and immediately cease operations if an endangered or threatened species was sighted.

OTHER PERMITS . . . Other routine permits include an EPA Pollution Plan, Highway Department and Railroad ROW. No problem was experienced in obtaining these permits.

OPERATION . . . The Authority is providing consistent high-quality water that meets all Drinking Water Standards. Operation of the plant continues around the clock, 24-hours per day. At 10 MGD capacity, the plant provides a savings of approximately 11,200 acre-feet of water rights, which would have been taken from the region's primary surface water source, the Rio Grande.

The Authority entered into an Interlocal Agreement with the BPUB to provide administrative services for the Authority. Currently, eleven employees are assigned to the Project, including six Operators, a Chief Operator, two Lead Operators, a Maintenance Worker, and an Administrative Assistant. Most shifts are covered by a single operator. Additional BPUB manpower and expertise is utilized on an as-needed basis.

The plant began startup operations during April 2004 and became fully operational in 12 months. The in-service date for the project is April 1, 2005. The reverse osmosis treatment process operates at a design capacity of 8.0 million gallons per day, depending on demand by the participating entities. Blend water, in the amount up to 2.0 million gallons per day, is also utilized as warranted by operations staff to provide stabilization and add minerals back into the water. Blend water offers savings to chemical costs.

The City of Los Fresnos, VMUD, BPUB, and BND are receiving water from the Project. Town of Indian Lake, which owns 0.20%, has not begun receiving water because of trans-boundary issues related to distribution. However, an alternate delivery system has been developed. As of January 1, 2009, City of Los Fresnos is purchasing Town of Indian Lake's water allocation, as per Interlocal Agreement. Additional distribution lines are also being installed to deliver a greater amount of water to BPUB.

Since operation, the Project has provided the City of Los Fresnos, VMUD, and the BPUB with an alternate water source during scheduled shutdown of these entities' primary supplies. This decreases service interruptions and increases service reliability, and reduces risks associated with reduced system pressures.

Operators receive formal training through regional trainings, vendors, and on-the-job training. As membrane treatment is becoming more prevalent, training opportunities are increasing. TCEQ has approved a training and certification program for the operation of reverse osmosis plants.

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DEBT INFORMATION

TABLE 1 - DEBT SERVICE REQUIREMENTS

Fiscal Year Ended 9/30	Total Outstanding Debt	Less Refunded Bonds Debt	The Series 2017 Bonds			Issuer Contribution at Closing	Total Outstanding Debt
			Principal	Interest	Total		
			2017	\$ 2,324,141	\$ 208,842		
2018	2,327,389	417,684	-	360,850	360,850		2,270,555
2019	2,354,639	1,352,684	935,000	360,850	1,295,850		2,297,805
2020	2,338,264	396,259	-	332,800	332,800		2,274,805
2021	2,334,269	394,999	-	332,800	332,800		2,272,070
2022	2,337,476	393,739	-	332,800	332,800		2,276,537
2023	2,337,644	392,479	-	332,800	332,800		2,277,965
2024	2,339,574	396,219	-	332,800	332,800		2,276,155
2025	2,338,214	394,749	-	332,800	332,800		2,276,265
2026	2,343,044	393,279	-	332,800	332,800		2,282,565
2027	2,334,084	391,809	-	332,800	332,800		2,275,075
2028	2,517,864	1,925,339	1,540,000	332,800	1,872,800		2,465,325
2029	2,515,874	1,924,399	1,600,000	271,200	1,871,200		2,462,675
2030	2,231,955	1,921,955	1,660,000	207,200	1,867,200		2,177,200
2031	2,231,830	1,921,830	1,725,000	140,800	1,865,800		2,175,800
2032	2,232,490	1,922,490	1,795,000	71,800	1,866,800		2,176,800
2033	310,000	-	-	-	-		310,000
2034	310,000	-	-	-	-		310,000
2035	310,000	-	-	-	-		310,000
2036	310,000	-	-	-	-		310,000
2037	310,000	-	-	-	-		310,000
2038	310,000	-	-	-	-		310,000
2039	305,000	-	-	-	-		305,000
	<u>\$ 39,603,749</u>	<u>\$ 14,748,752</u>	<u>\$ 9,255,000</u>	<u>\$ 4,541,214</u>	<u>\$ 13,796,214</u>	<u>\$ 54,531</u>	<u>\$ 38,705,742</u>

ANTICIPATED ISSUANCE OF DEBT . . . The Authority does not anticipate the issuance of additional debt within the ensuing 12 month period.

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INVESTMENTS

The Authority invests its investable funds in investments authorized by Texas law in accordance with investment policies approved by the Board. Both State law and the Authority's investment policies are subject to change.

LEGAL INVESTMENTS . . . Under Texas law, the Authority is authorized to invest in (1) obligations, including letters of credit, of the United States or its agencies and instrumentalities, (2) direct obligations of the State of Texas or its agencies and instrumentalities, (3) collateralized mortgage obligations directly issued by a federal agency or instrumentality of the United States, the underlying security for which is guaranteed by an agency or instrumentality of the United States, (4) other obligations, the principal and interest of which are unconditionally guaranteed or insured by, or backed by the full faith and credit of the State of Texas or the United States or their respective agencies and instrumentalities, (5) obligations of states, agencies, counties, cities, and other political subdivisions of any state rated as to investment quality by a nationally recognized investment rating firm not less than A or its equivalent, (6) (a) certificates of deposit and share certificates issued by a depository institution that has its main office or branch office in the State of Texas, that are guaranteed or insured by the Federal Deposit Insurance Corporation or the National Credit Union Share Insurance Fund or their respective successors, or are secured as to principal by obligations described in clauses (1) through (5) and clause (13) or in any other manner and amount provided by law for Authority deposits, and in addition (b) the Authority is authorized, subject to certain conditions, to invest in certificates of deposit with a depository institution that has its main office or branch office in the State of Texas and that participates in the Certificate of Deposit Account Registry Service® network (CDARS®) and as further provided by Texas law, (7) fully collateralized repurchase agreements that have a defined termination date, are fully secured by obligations described in clause (1) and require the security being purchased by the Authority to be pledged to the Authority, held in the Authority's name and deposited at the time the investment is made with the Authority or with a third party selected and approved by the Authority, and are placed through a primary government securities dealer or a financial institution doing business in the State of Texas, (8) bankers' acceptances with the remaining term of 270 days or less from the date of issuance, if the short-term obligations of the accepting bank or its parent are rated at least A-1 or P-1 or the equivalent by at least one nationally recognized credit rating agency, (9) commercial paper with the remaining term of 270 days or less from the date of issuance that is rated at least A-1 or P-1 or the equivalent by at least (a) two nationally recognized credit rating agencies or (b) one nationally recognized credit rating agency if the paper is fully secured by an irrevocable letter of credit issued by a U.S. or state bank, (10) no-load money market mutual funds registered with and regulated by the Securities and Exchange Commission that have a dollar weighted average portfolio maturity of 90 days or less and include in their investment objectives the maintenance of a stable net asset value of \$1 for each share, (11) no-load mutual fund registered with the United States Securities and Exchange Commission that: have an average weighted maturity of less than two years; invest exclusively in obligations described in the preceding clauses and clause (13), and are continuously rated as to investment quality by at least one nationally recognized investment rating firm of not less than AAA or its equivalent, (12) public funds investment pools that have an advisory board which includes participants in the pool and are continuously rated as to investment quality by at least one nationally recognized investment rating firm of not less than AAA or its equivalent or no lower than investment grade with a weighted average maturity no greater than 90 days, and (13) bonds issued, assumed or guaranteed by the State of Israel. Texas law also permits the Authority to invest bond proceeds in a guaranteed investment contract subject to the limitations set forth in Chapter 2256, as amended, Texas Government Code.

The Authority may enter into securities lending programs if (i) the securities loaned under the program are 100% collateralized including accrued income, a loan made under the program allows for termination at any time and a loan made under the program is either secured by (a) obligations that are described in clauses (1) through (5) and clause (13) above, (b) pledged irrevocable letters of credit issued by a state or national bank that is continuously rated by a nationally recognized investment rating firm at not less than A or its equivalent or (c) cash invested in obligations described in clauses (1) through (5) and clause (13) above, clause (9) above and clauses (10) and (11) above, or an authorized investment pool; (ii) securities held as collateral under a loan are pledged to such investing entity or a third party designated by such investing entity; (iii) a loan made under the program is placed through either a primary government securities dealer or a financial institution doing business in the State of Texas; and (iv) the agreement to lend securities has a term of one year or less.

The Authority may invest in such obligations directly or through government investment pools that invest solely in such obligations provided that the pools are rated no lower than AAA or AAAM or an equivalent by at least one nationally recognized rating service. The Authority is specifically prohibited from investing in: (1) obligations whose payment represents the coupon payments on the outstanding principal balance of the underlying mortgage-backed security collateral and pays no principal; (2) obligations whose payment represents the principal stream of cash flow from the underlying mortgage-backed security and bears no interest; (3) collateralized mortgage obligations that have a stated final maturity of greater than 10 years; and (4) collateralized mortgage obligations the interest rate of which is determined by an index that adjusts opposite to the changes in a market index.

INVESTMENT POLICIES . . . Under Texas law, the Authority is required to invest its funds under written investment policies that primarily emphasize safety of principal and liquidity; that address investment diversification, yield, maturity, and the quality and capability of investment management; and that includes a list of authorized investments for Authority funds, maximum allowable stated maturity of any individual investment and the maximum average dollar-weighted maturity allowed for pooled fund groups. All Authority funds must be invested consistent with a formally adopted "Investment Strategy Statement" that specifically addresses each fund's investment. Each Investment Strategy Statement will describe its objectives concerning: (1) suitability of investment type, (2) preservation and safety of principal, (3) liquidity, (4) marketability of each investment, (5) diversification of the portfolio, and (6) yield.

Under Texas law, Authority investments must be made "with judgment and care, under prevailing circumstances, that a person of prudence, discretion, and intelligence would exercise in the management of the person's own affairs, not for speculation, but for investment, considering the probable safety of capital and the probable income to be derived." At least quarterly, the investment officers of the Authority shall submit an investment report detailing: (1) the investment position of the Authority, (2) that all investment officers jointly prepared and signed the report, (3) the ending market value of each pooled fund group, (4) the book value and market value of each separately listed asset at the beginning and end of the reporting period, (5) the maturity date of each separately invested asset, (6) the account or fund or pooled fund group for which each individual investment was acquired, and (7) the compliance of the investment portfolio as it relates to: (a) adopted investment strategy statements and (b) state law. No person may invest Authority funds without express written Authority from the Board of Directors.

ADDITIONAL PROVISIONS . . . Under Texas law, the Authority is additionally required to: (1) annually review its adopted policies and strategies, (2) adopt a rule, order, ordinance or resolution stating that it has reviewed its investment policy and investment strategies and records any changes made to either its investment policy or investment strategy in the respective rule, order, ordinance or resolution, (3) require any investment officers with personal business relationships or relatives with firms seeking to sell securities to the entity to disclose the relationship and file a statement with the Texas Ethics Commission and the Board of Trustees; (4) require the qualified representative of firms offering to engage in an investment transaction with the Authority to: (a) receive and review the Authority's investment policy, (b) acknowledge that reasonable controls and procedures have been implemented to preclude investment transactions conducted between the Authority and the business organization that are not authorized by the Authority's investment policy (except to the extent that this authorization is dependent on an analysis of the makeup of the Authority's entire portfolio or requires an interpretation of subjective investment standards), and (c) deliver a written statement in a form acceptable to the Authority and the business organization attesting to these requirements; (5) perform an annual audit of the management controls on investments and adherence to the Authority's investment policy; (6) provide specific investment training for the Chief Financial Officer and investment officers; (7) restrict reverse repurchase agreements to not more than 90 days and restrict the investment of reverse repurchase agreement funds to no greater than the term of the reverse purchase agreement; (8) restrict the investment in no-load mutual funds in the aggregate to no more than 15% of the Authority's monthly average fund balance, excluding bond proceeds and reserves and other funds held for debt service; (9) require local government investment pools to conform to the new disclosure, rating, net asset value, yield calculation, and advisory board requirements, and (10) at least annually review, revise, and adopt a list of qualified brokers that are authorized to engage in investment transactions with the Authority.

As of September 30, 2016 all of the available funds (unaudited) of the Authority were on deposit as follows:

U.S. Treasury Note	\$	554,629
Money Market Mutual Funds		252,681
Certificate of Deposit		1,164,000
Local Government Investment Pools		3,560,989
Total	\$	<u>5,532,299</u>

TAX MATTERS

TAX EXEMPTION . . . The delivery of the Bonds is subject to the opinion of Andrews Kurth Kenyon LLP, Bond Counsel, to the effect that interest on the Bonds for federal income tax purposes (1) is excludable from the gross income, as defined in section 61 of the Internal Revenue Code of 1986, as amended to the date hereof (the "Code"), of the owners thereof pursuant to section 103 of the Code and existing regulations, published rulings, and court decisions, and (2) will not be included in computing the alternative minimum taxable income of the owners thereof who are individuals or, except as hereinafter described, corporations. The statute, regulations, rulings, and court decisions on which such opinion is based are subject to change. A form of Bond Counsel's opinion appears in APPENDIX F attached hereto.

Interest on the Bonds owned by a corporation will be included in such corporation's adjusted current earnings for purposes of calculating the alternative minimum taxable income of such corporation, other than an S corporation, a qualified mutual fund, a real estate investment trust (REIT), a financial asset securitization investment trust (FASIT), or a real estate mortgage investment conduit (REMIC). A corporation's alternative minimum taxable income is the basis on which the alternative minimum tax imposed by section 55 of the Code will be computed.

In rendering the foregoing opinions, Bond Counsel will rely upon the Sufficiency Certificate of Estrada Hinojosa & Company, Inc., as a financial advisor to the Authority, regarding the sufficiency of the deposit to the Escrow Fund on the date of Closing and upon representations and certifications of the Authority made in a certificate of even date with the initial delivery of the Bonds pertaining to the use, expenditure, and investment of the proceeds of the Bonds and will assume continuing compliance with the provisions of the Indenture by the Authority subsequent to the issuance of the Bonds. The Indenture contains covenants by the Authority with respect to, among other matters, the use of the proceeds of the Bonds and the facilities and equipment financed or refinanced therewith by persons other than state or local governmental units, the manner in which the proceeds of the Bonds are to be invested, the calculation and payment to the United States Treasury of any arbitrage "profits," if required, and the reporting of certain information to the United States Treasury. Failure to comply with any of these covenants may cause interest on the Bonds to be includable in the gross income of the owners thereof from the date of the issuance of the Bonds.

Except as described above, Bond Counsel will express no other opinion with respect to any other federal, state or local tax consequences under present law, or proposed legislation, resulting from the receipt or accrual of interest on, or the acquisition or disposition of, the Bonds.

Bond Counsel's opinion is not a guarantee of a result, but represents its legal judgment based upon its review of existing statutes, regulations, published rulings and court decisions and the representations and covenants of the Authority described above. No ruling has been sought from the Internal Revenue Service (the "IRS") with respect to the matters addressed in the opinion of Bond Counsel, and Bond Counsel's opinion is not binding on the IRS. The IRS has an ongoing program of auditing the tax-exempt status of the interest on municipal obligations. If an audit of the Bonds is commenced, under current procedures the IRS is likely to treat the Authority as the "taxpayer," and the owners of the Bonds would have no right to participate in the audit process. In responding to or defending an audit of the tax-exempt status of the interest on the Bonds, the Authority may have different or conflicting interests from the owners of the Bonds. Public awareness of any future audit of the Bonds may adversely affect the value and liquidity of the Bonds during the pendency of the audit, regardless of its ultimate outcome.

TAX CHANGES . . . Existing law may change to reduce or eliminate the benefit to bondholders of the exclusion of interest on the Bonds from gross income for federal income tax purposes. Any proposed legislation or administrative action, whether or not taken, could also affect the value and marketability of the Bonds. Prospective purchasers of the Bonds should consult with their own tax advisors with respect to any proposed or future changes in tax law.

ANCILLARY TAX CONSEQUENCES . . . Prospective purchasers of the Bonds should be aware that the ownership of tax-exempt obligations such as the Bonds may result in collateral federal tax consequences to, among others, financial institutions, property and casualty insurance companies, life insurance companies, certain foreign corporations doing business in the United States, S corporations with subchapter C earnings and profits, owners of an interest in a FASIT, individual recipients of Social Security or Railroad Retirement benefits, individuals otherwise qualifying for the earned income tax credit and taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry, or who have paid or incurred certain expenses allocable to, tax-exempt obligations. Prospective purchasers should consult their own tax advisors as to the applicability of these consequences to their particular circumstances.

TAX ACCOUNTING TREATMENT OF DISCOUNT BONDS . . . The initial public offering price to be paid for certain Bonds may be less than the amount payable on such Bonds at maturity (the "Discount Bonds"). An amount equal to the difference between the initial public offering price of a Discount Bond (assuming that a substantial amount of the Discount Bonds of that maturity are sold to the public at such price) and the amount payable at maturity constitutes original issue discount to the initial purchaser of such Discount Bonds. A portion of such original issue discount, allocable to the holding period of a Discount Bond by the initial purchaser, will be treated as interest for federal income tax purposes, excludable from gross income on the same terms and conditions as those for other interest on the Bonds. Such interest is considered to be accrued actuarially in accordance with the constant interest method over the life of a Discount Bond, taking into account the semiannual compounding of accrued interest, at the yield to maturity on such Discount Bond and generally will be allocated to an initial purchaser in a different amount from the amount of the payment denominated as interest actually received by the initial purchaser during his taxable year.

However, such accrued interest may be required to be taken into account in determining the alternative minimum taxable income of a corporation, for purposes of calculating a corporation's alternative minimum tax imposed by section 55 of the Code, and the amount of the branch profits tax applicable to certain foreign corporations doing business in the United States, even though there will not be a corresponding cash payment. In addition, the accrual of such interest may result in certain other collateral federal income tax consequences to, among others, financial institutions, property and casualty insurance companies, life insurance companies, S corporations with subchapter C earnings and profits, owners of an interest in a FASIT, individual recipients of Social Security or Railroad Retirement benefits, individuals otherwise qualifying for the earned income tax credit, and taxpayers who may be deemed to have incurred or continued indebtedness to purchase or carry, or who have paid or incurred certain expenses allocable to, tax-exempt obligations.

In the event of the sale or other taxable disposition of a Discount Bond prior to maturity, the amount realized by such owner in excess of the basis of such Discount Bond in the hands of such owner (adjusted upward by the portion of the original issue discount allocable to the period for which such Discount Bond was held) is includable in gross income.

Owners of Discount Bonds should consult with their own tax advisors with respect to the determination for federal income tax purposes of accrued interest upon disposition of Discount Bonds and with respect to the state and local tax consequences of owning Discount Bonds. It is possible that, under applicable provisions governing determination of state and local income taxes, accrued interest on the Discount Bonds may be deemed to be received in the year of accrual even though there will not be a corresponding cash payment.

TAX ACCOUNTING TREATMENT OF PREMIUM BONDS . . . The initial public offering price to be paid for certain Bonds may be greater than the stated redemption price on such Bonds at maturity (the "Premium Bonds"). An amount equal to the difference between the initial public offering price of a Premium Bond (assuming that a substantial amount of the Premium Bonds of that maturity are sold to the public at such price) and its stated redemption price at maturity constitutes premium to the initial purchaser of such Premium Bonds. The basis for federal income tax purposes of a Premium Bond in the hands of such initial purchaser must be reduced each year by the amortizable bond premium, although no federal income tax deduction is allowed as a result of such reduction in basis for amortizable bond premium with respect to the Premium Bonds. Such reduction in basis will increase the amount of any gain (or decrease the amount of any loss) to be recognized for federal income tax purposes upon a sale or other taxable disposition of a Premium Bond. The amount of premium which is amortizable each year by an initial purchaser is determined by using such purchaser's yield to maturity.

Purchasers of the Premium Bonds should consult with their own tax advisors with respect to the determination of amortizable bond premium on Premium Bonds for federal income tax purposes and with respect to the state and local tax consequences of owning and disposing of Premium Bonds.

QUALIFIED TAX-EXEMPT OBLIGATIONS FOR FINANCIAL INSTITUTIONS . . . Section 265 of the Code provides, in general, that interest expense to acquire or carry tax-exempt obligations is not deductible from the gross income of the owner of such obligations. In addition, section 265 of the Code generally disallows 100% of any deduction for interest expense which is incurred by "financial institutions" described in such section and is allocable, as computed in such section, to tax-exempt interest on obligations acquired after August 7, 1986. Section 265(b) of the Code provides an exception to this interest disallowance rule for interest expense allocable to tax-exempt obligations (other than private activity bonds that are not qualified 501(c)(3) bonds) which are designated by an issuer as "qualified tax-exempt obligations." An issuer may designate obligations as "qualified tax-exempt obligations" only if the amount of the issue of which they are a part, when added to the amount of all other tax-exempt obligations (other than private activity bonds that are not qualified 501(c)(3) obligations and other than certain refunding bonds) issued or reasonably anticipated to be issued by the issuer during the same calendar year, does not exceed \$10,000,000.

The Authority has designated the Bonds as "qualified tax-exempt obligations" and will certify its expectation that the above-described \$10,000,000 ceiling will not be exceeded. Accordingly, it is anticipated that financial institutions which purchase the Bonds will not be subject to the 100% disallowance of interest expense allocable to interest on the Bonds under section 265(b) of the Code. However, the deduction for interest expense incurred by a financial institution which is allocable to the interest on the Bonds will be reduced by 20% pursuant to section 291 of the Code.

OTHER INFORMATION

RATINGS

The Bonds have been rated "AA" by S&P by virtue of a municipal bond insurance policy issued by BAM. The Bonds and the presently outstanding revenue debt of the Authority have been given an underlying unenhanced rating of "A2" by Moody's Investors Service, Inc. ("Moody's"). The presently outstanding revenue debt of the Authority has an underlying unenhanced rating of "A+" by Fitch. The Authority also has two issues outstanding which are insured by a commercial insurance company. An explanation of the significance of such ratings may be obtained from the companies furnishing such ratings. Any rating reflects only the view of the rating organization and the Authority makes no representation as to the appropriateness of any rating. There is no assurance that such ratings will continue for any given period of time or they will not be revised downward or withdrawn entirely by such rating organizations, if in the judgement of such organizations, circumstances so warrant. Any such downward revision or withdrawal of such ratings may have an adverse effect on the market price of the Bonds.

LITIGATION

The Authority is not a party to any litigation or other proceeding pending or to its knowledge, threatened, in any court, agency or other administrative body (either state or federal) which, if decided adversely to the Authority, would have a material adverse effect on the financial condition or operations of the Authority.

REGISTRATION AND QUALIFICATION OF BONDS FOR SALE

The sale of the Bonds has not been registered under the Federal Securities Act of 1933, as amended, in reliance upon the exemption provided thereunder by Section 3(a)(2); and the Bonds have not been qualified under the Securities Act of Texas in reliance upon various exemptions contained therein; nor have the Bonds been qualified under the securities acts of any jurisdiction. The Authority assumes no responsibility for qualification of the Bonds under the securities laws of any jurisdiction in which the Bonds may be sold, assigned, pledged, hypothecated or otherwise transferred. This disclaimer of responsibility for qualification for sale or other disposition of the Bonds shall not be construed as an interpretation of any kind with regard to the availability of any exemption from securities registration provisions.

LEGAL INVESTMENTS AND ELIGIBILITY TO SECURE PUBLIC FUNDS IN TEXAS

Section 1201.041 Texas Government Code as amended, provides that the Bonds are negotiable instruments governed by Chapter 8, Texas Business and Commerce Code, and are legal and authorized investments for insurance companies, fiduciaries, and trustees, and for the sinking funds of municipalities or other political subdivisions or public agencies of the State of Texas. With respect to investment in the Bonds by municipalities or other political subdivisions or public agencies of the State of Texas, the Public Funds Investment Act, Chapter 2256, Texas Government Code, requires that the Bonds be assigned a rating of at least "A" or its equivalent as to investment quality by a national rating agency. See "OTHER INFORMATION - Ratings" above. In addition, various provisions of the Texas Finance Code provide that, subject to a prudent investor standard, the Bonds are legal investments for state banks, savings banks, trust companies with a capital of one million dollars or more, and savings and loan associations. The Public Funds Collateral Act, Chapter 2257, Texas Government Code, provides that the Bonds are eligible to secure deposits of any public funds of the State, its agencies, and its political subdivisions, and are legal security for those deposits to the extent of their market value. No review by the Authority has been made of the laws in other states to determine whether the Bonds are legal investments for various institutions in those states.

LEGAL MATTERS

The Authority will furnish the Underwriter with a complete transcript of proceedings incident to the authorization and issuance of the Bonds, including the unqualified approving legal opinion of the Attorney General of the State of Texas to the effect that the Initial Bond is a valid and legally binding obligation of the Authority, and based upon examination of such transcript of proceedings, the approval of certain legal matters by Bond Counsel, to the effect that the Bonds, issued in compliance with the provisions of the Indenture, are valid and legally binding obligations of the Authority and, subject to the qualifications set forth herein under "TAX MATTERS", the interest on the Bonds is exempt from federal income taxation under existing statutes, published rulings, regulations, and court decisions. Bond Counsel has been retained by and only represents the Authority. The proposed form of Bond Counsel's opinion is contained in APPENDIX F.

Though it represents the Underwriter from time to time in matters unrelated to the issuance of the Bonds, Bond Counsel has been engaged by the Board and only represents the Board and the Authority in connection with the issuance of the Bonds. In their capacity as Bond Counsel, Andrews Kurth Kenyon LLP has reviewed the information appearing in the Official Statement under the caption "THE BONDS" (except for the subsection entitled "Bondholders' Remedies" and "Book-Entry Only System") as to which no opinion is expressed, solely to determine that such information conforms to and fairly summarizes the provisions of the Bonds and the Indenture referred to therein. Such firm has also read and participated in the drafting of certain other portions of the Official Statement including "OTHER INFORMATION - Legal Investments And Eligibility To Secure Public Funds In Texas," "TAX MATTERS," "OTHER INFORMATION - Continuing Disclosure of Information (except for the information under "Compliance with Prior Undertakings", as to which no opinion is expressed)," "OTHER INFORMATION - Registration and Qualification of Bonds For Sale" and "OTHER INFORMATION - Legal Matters" and such firm is of the opinion that the statements and information contained therein are correct as to matters of law. Such firm has not, however, independently verified any of the factual information contained in the Official Statement nor conducted an investigation of the affairs of the Authority or the Participating Customers for the purpose of passing upon the accuracy or completeness of the Official Statement. No person is entitled to rely upon such firm's limited participation as an assumption of responsibility for, or an expression of opinion of any kind with regard to the accuracy or completeness of any of the information contained herein except as set forth in the first three sentences of this paragraph. The fees of Bond Counsel for their service with respect to the Bonds are contingent upon the delivery of the Bonds. Certain legal matters will be passed upon for the Authority by Davidson, Troilo, Ream & Garza, P.C., San Antonio, Texas, General Counsel. Certain matters will be passed on for the Underwriter by Locke Lord LLP, Dallas, Texas. The fees of Counsel to the Underwriter for their services are contingent upon the delivery of the Bonds.

AUTHENTICITY OF FINANCIAL DATA AND OTHER INFORMATION

The financial data and other information contained herein have been obtained from Authority and Participating Customers' records, audited financial statements and other sources which are believed to be reliable. There is no guarantee that any of the assumptions or estimates contained herein will be realized. All of the summaries of the statutes, documents and resolutions contained in this Official Statement are made subject to all of the provisions of such statutes, documents and resolutions. These summaries do not purport to be complete statements of such provisions and reference is made to such documents for further information. Reference is made to original documents in all respects.

CONTINUING DISCLOSURE OF INFORMATION

In the Indenture, the Authority has made the following agreement for the benefit of the holders and beneficial owners of the Bonds. The Authority is required to observe the agreement for so long as it remains obligated to advance funds to pay the Bonds. Under the agreement, the Authority will be obligated to provide certain updated financial information and operating data annually and timely notice of specified material events to the Municipal Securities Rulemaking Board (the "MSRB"). The information provided to the MSRB will be available to the public free of charge via the Electronic Municipal Market Access ("EMMA") system through an internet website accessible at www.emma.msrb.org as described below under "Availability of Information."

ANNUAL REPORTS . . . The Authority will file, and file on behalf of or cause each Participating Customer, whose allocated portion of water under the Water Supply Contract exceeds 10% (a "Reporting Participant"), to file certain updated financial information and operating data to the MSRB annually. To date, only BPUB is a Reporting Participant. The information to be updated includes all quantitative financial information and operating data with respect to the Authority and Reporting Participant of the general type included in Appendix A, Appendix B, and Appendix D to this Official Statement. The Authority and the Reporting Participant, or the Authority on behalf of the Reporting Participant, will update and provide this information within six months after the end of each fiscal year ending in or after 2017. The Authority and the Reporting Participant, or the Authority on behalf of the Reporting Participant, will provide the updated information to the MSRB in an electronic format, which will be available through EMMA to the general public without charge.

The Authority and the Reporting Participant may provide updated information in full text or may incorporate by reference certain other publicly available documents, as permitted by the United States Securities and Exchange Commission's Rule 15c2-12 (the "Rule"). The updated information will include audited financial statements, if the Authority or the Reporting Participant commission an audit and it is completed by the required time. If audited financial statements are not available by the required time, the Authority and the Reporting Participant, or the Authority on behalf of the Reporting Participant, will provide unaudited financial statements by the required time, and will provide audited financial statements when and if the audit report becomes available. Any such financial statements will be prepared in accordance with the accounting principles as the Authority and the Reporting Participant may be required to employ from time to time pursuant to state law or regulation.

Both the Authority's and the Reporting Participant's current fiscal year end is September 30. Accordingly, they must provide updated information by March 31 of the following year, unless the Authority or the Reporting Participant change their fiscal year. If the Authority or the Reporting Participant change their fiscal year, they will file notice of such change with the MSRB through EMMA.

NOTICE OF CERTAIN EVENTS . . . The Authority will also provide notices of certain events to the MSRB. The Authority will provide notice of any of the following events with respect to the Bonds to the MSRB in a timely manner and not more than 10 business days after occurrence of the event: (1) principal and interest payment delinquencies; (2) non-payment related defaults, if material; (3) unscheduled draws on debt service reserves reflecting financial difficulties; (4) unscheduled draws on credit enhancements reflecting financial difficulties; (5) substitution of credit or liquidity providers, or their failure to perform; (6) adverse tax opinions, the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB), or other material notices or determinations with respect to the tax-exempt status of the Bonds, or other material events affecting the tax status of the Bonds; (7) modifications to rights of holders of the Bonds, if material; (8) bond calls, if material, and tender offers; (9) defeasances; (10) release, substitution, or sale of property securing repayment of the Bonds, if material; (11) rating changes; (12) bankruptcy, insolvency, receivership, or similar event of the Authority, which shall occur as described below; (13) the consummation of a merger, consolidation, or acquisition involving the Authority or the sale of all or substantially all of its assets, other than in the ordinary course of business, the entry into of a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material; and (14) appointment of a successor or additional trustee or the change of name of a trustee, if material. For these purposes, any event described in the immediately preceding paragraph (12) is considered to occur when any of the following occur: the appointment of a receiver, fiscal agent, or similar officer for the Authority or the Reporting Participant in a proceeding under the United States Bankruptcy Code or in any other proceeding under state or federal law in which a court or governmental authority has assumed jurisdiction over substantially all of the assets or business of the Authority or the Reporting Participant, respectively, or if such jurisdiction has been assumed by leaving the existing governing body and officials or officers in possession but subject to the supervision and orders of a court or governmental authority, or the entry of an order confirming a plan of reorganization, arrangement, or liquidation by a court or governmental authority having supervision or jurisdiction over substantially all of the assets or business of the Authority or the Reporting Participant, respectively. Neither the Bonds nor the Indenture make any provision for credit enhancement or liquidity enhancement. In addition, the Authority and the Reporting Participant will provide timely notice of any failure by the Authority or the Reporting Participant, as applicable, to provide information, data, or financial statements in accordance with its agreement described above under "Annual Reports". The Authority and the Reporting Participant will provide each notice described in this paragraph to the MSRB.

AVAILABILITY OF INFORMATION . . . Effective July 1, 2009 (the "EMMA Effective Date"), the SEC implemented amendments to the Rule which approved the establishment by the MSRB of EMMA, which is now the sole successor to the national municipal securities information repositories with respect to filings made in connection with undertakings made under the Rule after the EMMA Effective Date. Commencing with the EMMA Effective Date, all information and documentation filing required to be made by the Authority and Reporting Participant in accordance with its undertaking made for the Bonds will be made with the MSRB in electronic format in accordance with MSRB guidelines. Access to such filings will be provided, without charge to the general public, by the MSRB.

With respect to debt of the Authority and the Reporting Participant issued prior to the EMMA Effective Date, the Authority and the Reporting Participant remain obligated to make annual required filings, as well as notices of material events, under its continuing disclosure obligations relating to those debt obligations (which includes a continuing obligation to make such filings with the Texas state information depository (the "SID")). Prior to EMMA Effective Date, the Municipal Advisory Council of Texas (the "MAC") had been designated by the State and approved by the SEC staff as a qualified SID. Subsequent to the EMMA Effective Date, the MAC entered into a Subscription Agreement with the MSRB pursuant to which the MSRB makes available to the MAC, in electronic format, all Texas-issuer continuing disclosure documents and related information posted to EMMA's website simultaneously with such posting. Until the Authority and Reporting Participant receive notice of a change in this contractual agreement between the MAC and EMMA or of a failure of either party to perform as specified thereunder, the Authority and Reporting Participant have determined, in reliance on guidance from the MAC, that making its continuing disclosure filings solely with the MSRB will satisfy its obligations to make filings with the SID pursuant to its continuing disclosure agreements entered into prior to the EMMA Effective Date.

LIMITATIONS AND AMENDMENTS . . . The Authority and Reporting Participant have agreed to update information and to provide notices of material events only as described above. The Authority and Reporting Participant have not agreed to provide other information that may be relevant or material to a complete presentation of its financial results of operations, condition, or prospects or agreed to update any information that is provided, except as described above. The Authority and Reporting Participant make no representation or warranty concerning such information or concerning its usefulness to a decision to invest in or sell Bonds at any future date. The Authority and Reporting Participant disclaim any contractual or tort liability for damages resulting in whole or in part from any breach of its continuing disclosure agreement or from any statement made pursuant to its agreement, although holders or registered owners of Bonds may seek a writ of mandamus to compel the Authority and Reporting Participant to comply with its agreement.

The Authority and Reporting Participant may amend their continuing disclosure agreement to adapt to changed circumstances that arise from a change in legal requirements, a change in law, or a change in the identity, nature, status, or type of operations of the Authority and Reporting Participant, if the agreement, as amended, would have permitted an underwriter to purchase or sell Bonds in the offering described herein in compliance with the Rule and either the holders of a majority in aggregate principal amount of the outstanding Bonds consent or any person unaffiliated with the Authority and Reporting Participant (such as nationally recognized bond counsel) determine that the amendment will not materially impair the interests of the holders or beneficial owners of the Bonds. If the Authority and Reporting Participant amend their agreement, it must include with the next financial information and operating data provided in accordance with its agreement described above under "Annual Reports" an explanation, in narrative form, of the reasons for the amendment and of the impact of any change in the type of information and data provided. The Authority and Reporting Participant may also amend or repeal the provisions of this continuing disclosure agreement if the SEC amends or repeals the applicable provision of the Rule or a court of final jurisdiction enters judgment that such provisions of the Rule are invalid, but only if and to the extent that the provisions of this sentence would not prevent an underwriter from lawfully purchasing or selling Bonds, respectively, in the primary offering of the Bonds.

COMPLIANCE WITH PRIOR UNDERTAKINGS . . . During the past five years, the Authority and the Reporting Participant, BPUB, have complied in all material respects with continuing disclosure agreements made by it in accordance with SEC Rule 15c2-12.

FINANCIAL ADVISOR

Estrada Hinojosa & Company, Inc. is employed as Financial Advisor to the Authority in connection with the issuance of the Bonds. The Financial Advisor's fee for services rendered with respect to the sale of the Bonds is contingent upon the issuance and delivery of the Bonds. Estrada Hinojosa & Company, Inc., in its capacity as Financial Advisor, has relied on the opinion of Bond Counsel and has not verified and does not assume any responsibility for the information, covenants and representations contained in any of the legal documents with respect to the federal income tax status of the Bonds, or the possible impact of any present, pending or future actions taken by any legislative or judicial bodies. **In the normal course of business, the Financial Advisor may from time to time sell investment securities to the Authority for the investment of bond proceeds or other funds of the Authority upon the request of the Authority.**

The Financial Advisor has reviewed the information in this Official Statement in accordance with, and as part of, its responsibilities to the Authority and, as applicable, to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Financial Advisor does not guarantee the accuracy or completeness of such information.

UNDERWRITING

The Underwriter has agreed, subject to certain conditions, to purchase the Bonds from the Authority, at an underwriting discount of \$58,354.41 and no accrued interest on the Bonds. The Underwriter will be obligated to purchase all of the Bonds if any Bonds are purchased. The Bonds to be offered to the public may be offered and sold to certain dealers (including the Underwriter and other dealers depositing Bonds into investment trusts) at prices lower than the public offering prices of such Bonds, and such public offering prices may be changed, from time to time, by the Underwriter.

The Underwriter has provided the following sentence for inclusion in this Official Statement. The Underwriter has reviewed the information in this Official Statement in accordance with its responsibilities to investors under the federal securities laws as applied to the facts and circumstances of this transaction, but the Underwriter does not guarantee the accuracy or completeness of such information.

RBC Capital Markets, LLC (the "Underwriter") has provided the following information for inclusion in this Official Statement: The Underwriter and its respective affiliates are full-service financial institutions engaged in various activities, that may include securities trading, commercial and investment banking, municipal advisory, brokerage, and asset management. In the ordinary course of business, the Underwriter and its respective affiliates may actively trade debt and, if applicable, equity securities (or related derivative securities) and provide financial instruments (which may include bank loans, credit support or interest rate swaps). The Underwriter and its respective affiliates may engage in transactions for their own accounts involving the securities and instruments made the subject of this securities offering or other offering of the Authority. The Underwriter and its respective affiliates may also communicate independent investment recommendations, market color or trading ideas and publish independent research views in respect of this securities offering or other offerings of the Authority. The Underwriter and its respective affiliates may make a market in credit default swaps with respect to municipal securities in the future.

FORWARD-LOOKING STATEMENTS DISCLAIMER

The statements contained in this Official Statement, and in any other information provided by the Authority or BPUB, that are not purely historical, are forward-looking statements, including statements regarding the Authority or BPUB expectations, hopes, intentions, or strategies regarding the future. Readers should not place undue reliance on forward-looking statements. All forward-looking statements included in this Official Statement are based on information available to the Authority or BPUB on the date hereof, and the Authority or BPUB assumes no obligation to update any such forward-looking statements. The Authority's or BPUB's actual results could differ materially from those discussed in such forward-looking statements.

The forward-looking statements included herein are necessarily based on various assumptions and estimates and are inherently subject to various risks and uncertainties, including risks and uncertainties relating to the possible invalidity of the underlying assumptions and estimates and possible changes or developments in social, economic, business, industry, market, legal, and regulatory circumstances and conditions and actions taken or omitted to be taken by third parties, including customers, suppliers, business partners and competitors, and legislative, judicial, and other governmental authorities and officials. Assumptions related to the foregoing involve judgments with respect to, among other things, future economic, competitive, and market conditions and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond the control of the Authority or BPUB. Any of such assumptions could be inaccurate and, therefore, there can be no assurance that the forward-looking statements included in this Official Statement will prove to be accurate.

SPECIAL RELATIONSHIPS

In addition to acting as Bond Counsel for this transaction, Andrews Kurth Kenyon LLP also serves as bond counsel to BPUB. Estrada Hinojosa & Company, Inc. is acting as Financial Advisor to the Authority and also serves as financial advisor to the City of Brownsville and the BPUB in this and other transactions. BPUB is a Participating Customer in the Project and will supply electricity and provide operations services for the Project. The General Manager of BPUB serves as a Director and the Deputy Secretary/Treasurer of the Authority.

MISCELLANEOUS

The financial data and other information contained herein have been obtained from the Authority's and BPUB's records, audited financial statements and other sources which are believed to be reliable. There is no guarantee that any of the assumptions or estimates contained herein will be realized. All of the summaries of the statutes, documents and resolutions contained in this Official Statement are made subject to all of the provisions of such statutes, documents and resolutions. These summaries do not purport to be complete statements of such provisions and reference is made to such documents for further information. Reference is made to original documents in all respects.

The Resolution authorizing the issuance of the Bonds will also approve the form and content of this Official Statement, and any addenda, supplement or amendment thereto, and authorize its further use in the reoffering of the Bonds by the Underwriter.

SOUTHMOST REGIONAL WATER AUTHORITY

/s/ Rafael Vela
President, Board of Directors

ATTEST:

/s/ Honorable Barbara Collum
Secretary, Board of Directors

SCHEDULE I

SCHEDULE OF REFUNDED BONDS

Bond	Maturities	Interest Rate	Par Amount	Call Date	Call Price
Water Supply Contract Revenue Refunding Bonds, Series 2006 (Desalination Plant Project)					
Serials	9/1/2029	4.125%	\$ 1,635,000	5/18/2017	100.00%
	9/1/2030	4.125%	1,700,000	5/18/2017	100.00
Term 2019	9/1/2019	5.500%	935,000	5/18/2017	100.00
Term 2028	9/1/2020	4.200%	30,000	5/18/2017	100.00
	9/1/2021	4.200%	30,000	5/18/2017	100.00
	9/1/2022	4.200%	30,000	5/18/2017	100.00
	9/1/2023	4.200%	30,000	5/18/2017	100.00
	9/1/2024	4.200%	35,000	5/18/2017	100.00
	9/1/2025	4.200%	35,000	5/18/2017	100.00
	9/1/2026	4.200%	35,000	5/18/2017	100.00
	9/1/2027	4.200%	35,000	5/18/2017	100.00
	9/1/2028	4.200%	1,570,000	5/18/2017	100.00
Term 2032	9/1/2031	4.200%	1,770,000	5/18/2017	100.00
	9/1/2032	4.200%	1,845,000	5/18/2017	100.00
			\$ 9,715,000		

APPENDIX A
EXCERPTS FROM THE
SOUTHMOST REGIONAL WATER AUTHORITY
ANNUAL FINANCIAL REPORT
For the Year Ended September 30, 2016

The information contained in this Appendix consists of excerpts from the Southmost Regional Water Authority Annual Financial Report for the Year Ended September 30, 2016, and is not intended to be a complete statement of the Authority's financial condition. Reference is made to the complete Report for further information.

NOTE: The Southmost Regional Water Authority is a component unit of the Public Utilities Board of the City of Brownsville, Texas (BPUB). Excerpts from a separate Comprehensive Annual Financial Report of BPUB are attached to this Official Statement as Appendix B.

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INDEPENDENT AUDITORS' REPORT

To the Board of Board of Directors
Southmost Regional Water Authority

Report on Financial Statements

We have audited the accompanying financial statements of the business-type activities of the Southmost Regional Water Authority (the Authority), a component unit of the Public Utilities Board of the City of Brownsville, Texas, as of and for the years ended September 30, 2016 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 opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall financial statement 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.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities of the Authority, as of September 30, 2016 and the changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Prior Period Financial Statements

The financial statements of the Public Utilities Board as of and for the year ended September 30, 2015, were audited by other auditors whose report dated January 18, 2016, expressed an unmodified opinion on those statements.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion on pages 7-13 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required 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 basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Authority's financial statements. The Other Supplementary Information and the Texas Supplementary Information as listed in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements. The schedule of expenditures of federal/state awards is presented for purposes of additional analysis as required by Title 2 U.S. *Code of Federal Regulations* (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*, and is also not a required part of the basic financial statements.

The schedule of expenditures of federal awards is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the

basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal/state awards is fairly stated in all material respects in relation to the basic financial statements as a whole.

The Other Supplementary Information and the Texas Supplementary Information has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on them.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated March 6, 2017, on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority's internal control over financial reporting and compliance.

Carr, Riggs & Ingram, LLC

CARR, RIGGS & INGRAM, LLC

Brownsville, Texas

March 6, 2017

**MANAGEMENT'S DISCUSSION
AND
ANALYSIS**

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the Southmost Regional Water Authority's (Authority) annual financial report presents our analysis of the Authority's financial performance during the fiscal years that ended on September 30, 2016 and 2015. In accordance with Government Accounting Standards Board ("GASB") Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis – for State and Local Governments*, this report has been prepared analyzing the financial operations of the Authority and should be read in conjunction with the financial statements and accompanying notes, which follow this section.

INTRODUCTION

The Authority was created under provisions of Section I, Chapter 511, Acts of the 67th State of Texas Legislature, Regular Session, 1981 for the purpose of developing alternative water supply strategies for the member entities. The Authority is a conservation and reclamation district organized pursuant to Article XVI, Section 59 of the Texas Constitution.

The Authority remained dormant until the year 2000 when it was activated to study the possibility of using brackish water as an alternative water source due to the limited supply available from the Rio Grande River. The study concluded that it was economically feasible to build a plant to treat brackish water based on the following key elements:

- Source of groundwater is independent of the Rio Grande River.
- Treatment of brackish ground water is competitive with the treatment of surface water.
- A savings on the cost of acquiring water rights from the Rio Grande River.
- Water quality is enhanced through the reverse osmosis treatment.

By embracing a regional approach to the water supply issues of the area, the member entities can take advantage of the cost savings attributed to the economies of scale realized from a larger regional treatment facility. Underground testing, completed in May 2002, projected a yield of 9.5 million gallons a day (MGD) of brackish raw water supply source to a new treatment facility. The first phase, well field and delivery cost, was approximately \$31.7 million, and was completed in June 2004. One of the major costs of the Project was infrastructure which included over 35 miles of raw and treated water pipe needed to supply each entity with water.

Allocation of water is based on the following percent allocation of the participant's water sales:

Brownsville Public Utilities Board	92.91 %
Valley Municipal Utility District #2	2.51 %
City of Los Fresnos	2.28 %
Brownsville Navigation District	2.10 %
Town of Indian Lake	.20 %

The brackish water treatment plant was built on 17 acres located on FM 511 approximately 1.3 miles west of Paredes Line Road (FM 1847). This area is on the north side of Brownsville, Texas and centrally located to all the member entities. The well field is located west of the Valley Municipal Utility District. Expressway 77/83 bounds it on the North and South by FM 1732 and on the West by Cameron County District No. 20 Main Canal.

NRS Engineering was authorized by the Authority to design a reverse osmosis (RO) water treatment system for a well field consisting of 20 wells. The engineering report provides a description of the process and equipment, design considerations, and control system. The original RO plant provided a permeate water capacity of 6.0 MGD with a blended plant capacity of 7.5 MGD.

In 2009, the Authority issued revenue bonds for the construction of a full scale Microfiltration Pretreatment System. The objective of the project was to achieve compliance with both existing and future maximum contaminant levels for arsenic in public drinking water by pretreating the brackish groundwater prior to entering the existing reverse osmosis treatment process. Another objective was to control and reduce iron levels to eliminate potential complaints of colored water. A final objective included an additional 2.5 MGD of capacity through upgrading certain pumps within the existing well field and adding two additional reverse osmosis trains. The project was completed in November 2015,

and the Microfiltration Pretreatment System is in full operation.

The Authority has no taxing power. Operation and maintenance costs are funded through guaranteed water supply contracts with the participating entities. The acquisition or construction of capital assets was funded through the selling of bonds with the entities guaranteeing the debt service payments, notes, and obligations issued under the indenture.

The Brownsville Public Utilities Board's (BPUB) allocated interest in the Authority is 92.91%. As such, the BPUB has a 92.91% voting majority in the Authority's Board. Additionally, the vast majority of the Authority's water supply is allocated and sold to the BPUB. Because of this significant interest by the BPUB, the Authority is considered to be a component unit of the BPUB.

FINANCIAL HIGHLIGHTS

- The Authority's net position increased by \$1,175,666 or 10.13 percent.
- During the year, the Authority's operating revenues increased \$436,843 or 7.06 percent, and operating expenses increased by \$432,261 or 10.84 percent.
- Capital assets of the Authority decreased by \$263,151 or 0.7 percent over last year.

OVERVIEW OF ANNUAL FINANCIAL REPORT

Management's Discussion and Analysis (MD&A) serves as an introduction to, and should be read in conjunction with, the basic audited financial statements and supplemental information. MD&A represents management's examination and analysis of the Authority's financial condition and performance. Summary financial statement data, key financial and operational indicators used in the Authority's budget, bond resolutions, and other management tools were used for this analysis.

The financial statements report information about the Authority using full accrual accounting methods as utilized by similar business activities in the private sector. The financial statements include a statement of net position, a statement of revenues, expenses, and changes in net position, a statement of cash flows, and notes to the financial statements.

The *statement of net position* presents the financial position of the Authority on a full accrual basis. The statement of net position presents information on all of the Authority's assets and liabilities, with the difference reported as net position. Over time, increases and decreases in net position are one indicator of whether the financial position of the Authority is improving or deteriorating.

While the statement of net position provides information about the nature and amount of resources and obligations at year-end, the *statement of revenues, expenses, and changes in net position* presents the results of the business activities over the course of the fiscal year and information as to how the net position changed during the year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. This statement also provides certain information about the Authority's recovery of its costs.

The *statement of cash flows* presents changes in cash and cash equivalents, resulting from operational, financing, and investing activities. This statement presents cash receipts and cash disbursement information, without consideration of the earnings event, when an obligation arises, or depreciation of capital assets.

The *notes to the financial statements* provide required disclosures and other information that are essential to a full understanding of material data provided in the statements. The notes present information about the Authority's accounting policies, significant account balances and activities, material risks, obligations, commitments, contingencies and subsequent events, if any.

Supplementary information comparing the budget to actual expenses is provided, as well as information required by the Texas Commission on Environmental Quality.

The financial statements were prepared by the BPUB's staff from the detailed books and records of the Authority. The financial statements were audited and adjusted, if material, during the independent external audit process.

FINANCIAL ANALYSIS

The following comparative condensed financial statements and other selected information serve as the key financial data and indicators for management, monitoring, and planning.

NET POSITION

A summary of the Authority's Statements of Net Position and Condensed Statements of Revenues, Expenses, and Changes in Net Position are presented in Table A-1 and Table A-2, respectively.

TABLE A-1
Statements of Net Position
September 30, 2016, 2015 and 2014

	FY 2016	FY 2015	FY 2014
Current and Other Assets	\$ 6,872,945	\$ 6,868,199	\$ 7,438,826
Capital Assets	37,238,908	37,502,059	37,224,230
Total Assets	<u>44,111,853</u>	<u>44,370,258</u>	<u>44,663,056</u>
Deferred Outflows of Resources	926,279	977,996	1,029,714
Total Assets Plus Deferred Outflows of Resources	<u>\$ 45,038,132</u>	<u>\$ 45,348,254</u>	<u>\$ 45,692,770</u>
Current Liabilities	\$ 2,072,564	\$ 2,173,890	\$ 2,411,168
Long Term Liabilities	30,187,879	31,572,341	32,911,805
Total Liabilities	<u>\$ 32,260,443</u>	<u>\$ 33,746,231</u>	<u>\$ 35,322,973</u>
Net Investment in Capital Assets	\$ 5,726,030	\$ 5,076,694	\$ 4,549,799
Restricted	2,876,892	2,679,906	2,864,140
Unrestricted	4,174,767	3,845,423	2,955,858
Total Net Position	<u>\$ 12,777,689</u>	<u>\$ 11,602,023</u>	<u>\$ 10,369,797</u>

A review of the Statement of Net Position indicates a decrease of total assets of \$258,405 for FY 2016, and a decrease in total liabilities of \$1,485,788. Additionally, total net position increased \$1,175,666 for FY 2016. The majority of the decrease in liabilities is attributable to construction expenses and bond principal and interest payments for the Micro Filtration Pretreatment System Expansion project. Deferred outflows of resources decreased \$51,717 in FY 2016 as a result of amortization of capitalized debt reacquisition costs.

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TABLE A-2
 Statements of Revenues, Expenses, and Changes in Net Position
 For Fiscal Years Ended September 30, 2016, 2015 and 2014

	<u>FY 2016</u>	<u>FY 2015</u>	<u>FY 2014</u>
Operating Revenues	\$ 6,622,653	\$ 6,185,810	\$ 6,753,978
Total Revenues	<u>\$ 6,622,653</u>	<u>\$ 6,185,810</u>	<u>\$ 6,753,978</u>
Depreciation Expense	\$ 931,124	\$ 864,865	\$ 864,865
Other Operating Expense	3,489,520	3,123,518	2,775,244
Non-Operating Expense	1,026,343	965,201	1,006,182
Total Expenses	<u>\$ 5,446,987</u>	<u>\$ 4,953,584</u>	<u>\$ 4,646,291</u>
Change in Net Position	\$ 1,175,666	\$ 1,232,226	\$ 2,107,687
Beginning Net Position	<u>11,602,023</u>	<u>10,369,797</u>	<u>8,262,110</u>
Ending Net Position	<u>\$ 12,777,689</u>	<u>\$ 11,602,023</u>	<u>\$ 10,369,797</u>

While the Statement of Net Position shows changes in net position, the Statements of Revenues, Expenses, and Changes in Net Position provides answers as to the nature and source of these changes. Member assessments increased by \$436,843 and expenses increased by \$493,403. The Authority incurred increases in operating expense of approximately \$432,261 from FY 2015, of which the majority represented increases in overhead labor, utilities, chemicals, other services, and maintenance expenses. The Authority incurred increases in operating expense in FY 2015 of approximately \$348,274 from FY 2014, of which the majority represented increases in overhead labor, utilities, chemicals, materials and supplies and maintenance expenses.

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BUDGETARY HIGHLIGHTS

As required by its Bond Indentures, the Authority shall prepare or cause to be prepared and deliver to the Participating Customer its proposed Annual Systems Budget at least 75 days prior to the start of its fiscal year. After due consideration in good faith of any written comments submitted, the Authority shall adopt the budget not less than 30 days prior to the beginning of the fiscal year. The budget remains in effect the entire year and is revised only if necessary through a budget amendment. The Fiscal Year 2016 Budget comparison schedule is presented as supplementary information and not reported on nor shown in the financial statement section of this report.

TABLE A-3
Operations and Maintenance Only
Budget vs. Actual

	FY 2016 Budget	FY 2016 Actual	Variance
Revenues From Operations:			
Operating Revenues	<u>\$ 4,026,265</u>	<u>\$ 4,026,265</u>	<u>\$ -</u>
Total Revenues	<u>\$ 4,026,265</u>	<u>\$ 4,026,265</u>	<u>\$ -</u>
Operating Expenses:			
Professional Fees	\$ 12,000	\$ 10,000	\$ 2,000
Director's Bonds	1,900	1,010	890
Legal Fees	25,000	7,040	17,960
Meeting Expenses	2,800	3,966	(1,166)
Contracted Services - Labor	576,943	578,682	(1,739)
Utilities	1,221,000	1,059,645	161,355
Other	<u>2,186,622</u>	<u>1,829,177</u>	<u>357,445</u>
Total Expenses	<u>\$ 4,026,265</u>	<u>\$ 3,489,520</u>	<u>\$ 536,745</u>
Change in Net Assets	<u>\$ -</u>	<u>\$ 536,745</u>	<u>\$ 536,745</u>

The Operations and Maintenance Budget to Actual Comparison Schedule indicates that the Authority exceeded budgeted expenses for contracted labor and meeting expenses while expenses for professional fees, director's bonds, legal fees, utilities, and other expenses were under budget. The significant variance for other expenses represents a decrease in legal fees of \$17,960, a decrease of \$161,355 in utility expense, and a decrease in the purchases of chemical of \$138,297.

FINANCIAL CONDITION

The Authority's financial condition continues to rest on the Water Supply Contract approved by all the participants in the Desalination Plant Project. All participating members were assessed and contributed their allocated portion of the 2016 Debt Service obligation and Annual Systems Budget.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets. At the end of FY 2016, the Authority's net investment in the Desalination Plant totaled \$37.2 million as shown in Table A-4.

TABLE A-4
Capital Assets
September 30, 2016, 2015 and 2014

	<u>FY 2016</u>	<u>FY 2015</u>	<u>FY 2014</u>
Land	\$ 1,802,935	\$ 1,802,935	\$ 1,802,935
Buildings and Structures	16,795,265	14,174,956	14,174,956
Plant	12,105,010	11,297,577	11,297,577
Improvements	2,731,230	-	-
Equipment	13,531,400	5,941,902	5,941,902
Construction in Progress	77,044	13,157,541	12,014,680
Subtotal	<u>47,042,884</u>	<u>46,374,911</u>	<u>45,232,050</u>
Less Accumulated Depreciation	<u>(9,803,976)</u>	<u>(8,872,852)</u>	<u>(8,007,820)</u>
Capital Assets, Net	<u>\$ 37,238,908</u>	<u>\$ 37,502,059</u>	<u>\$ 37,224,230</u>

Capital assets increased only slightly in FY 2016 at \$667,973 as compared to \$1,142,861 in FY 2015. Construction on the Microfiltration Pretreatment System ended during FY 2016. Depreciation expense for FY 2016 and FY 2015 was \$931,124 and \$864,865, respectively. Additional information on the Authority's capital assets can be found in Note 11 on pages 28-29 of this report.

Long-term debt. At the end of the current fiscal year, the Authority had total bonded debt outstanding of \$30.2 million. The bonds are secured solely by specified revenue sources.

TABLE A-5
Outstanding Debt
September 30, 2016, 2015 and 2014

	<u>FY 2016</u>	<u>FY 2015</u>	<u>FY 2014</u>
Revenue Bonds	\$ 30,240,000	\$ 31,520,000	\$ 32,760,000

On December 20, 2006, the Authority issued Water Supply Contract Revenue Refunding Bonds, Series 2006 in the amount of \$9,950,000. The 2006 Series refunding bonds were issued to refund Water Supply Contract Revenue Bonds, Series 2002 in the amount of \$9,360,000.

On December 7, 2009 the Authority issued \$9,295,000 in Water Supply Contract Revenue Bonds, Series 2009A and \$3,795,000 in Water Supply Contract Revenue Bonds, Series 2009B through the Texas Water Development Board Drinking Water State Revolving Fund for the construction of a full scale Micro Filtration Pretreatment System. The objective of this project is to achieve compliance with both existing and future maximum contaminant levels for arsenic in public drinking water by constructing a full scale Micro Filtration Pretreatment System prior to entering the existing reverse osmosis treatment process. An additional need is to control and reduce iron levels to eliminate complaints of colored water. Project objectives also include an additional 1.0 million gallons per day of capacity through upgrading certain pumps within the existing well field and adding one additional reverse osmosis train.

CAPITAL ASSETS AND DEBT ADMINISTRATION - Continued

Long-term debt – Continued

On September 26, 2012 the Authority issued \$13,530,000 in Water Supply Contract Revenue Refunding Bonds, Series 2012. The refunding bonds had a closing date of October 18, 2012 and the proceeds plus the bond premium were used to defease \$14,990,000 of the Series 2002 Revenue Bonds for the years 2013 through 2027.

The Authority continues to have insured bond ratings from the national rating agencies. The Authority's underlying ratings on its water supply contract revenue bonds are "A2" and "A+" by Moody's and Fitch Ratings, respectively.

Note 9 on pages 24-28 provides an explanation of the Authority's outstanding long-term debt as of September 30, 2016.

REQUEST OF INFORMATION

This financial report is designed to provide a general overview of the Authority's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or request for additional financial information should be addressed to the Chief Financial Officer, Southmost Regional Water Authority, P. O. Box 3270, Brownsville, Texas 78523-3270.

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BASIC FINANCIAL STATEMENTS

SOUTHMOST REGIONAL WATER AUTHORITY
STATEMENTS OF NET POSITION
September 30, 2016 and 2015

ASSETS	2016	2015
Current Assets:		
Cash - unrestricted	\$ 211,210	\$ 176,940
Cash - restricted	443,109	329,079
Investments - unrestricted	3,015,254	2,627,079
Investments - restricted	2,517,045	2,437,720
Due from other governments	194,526	787,197
Interest receivable	11,754	5,905
Prepaid expense	36,621	37,218
Total Current Assets	6,429,519	6,401,138
Capital Assets:		
Capital assets, net of accumulated depreciation	37,238,908	37,502,059
Other Assets:		
Unamortized regulatory assets	443,426	467,061
Total Assets	44,111,853	44,370,258
DEFERRED OUTFLOWS OF RESOURCES		
Deferred charge on refunding	926,279	977,996
Total Deferred Outflows of Resources	926,279	977,996
Total Assets plus Deferred Outflows of Resources \$	45,038,132	\$ 45,348,254
LIABILITIES AND NET POSITION		
Current Liabilities:		
Accounts payable	\$ 332,279	\$ 613,438
Accrued interest	83,262	86,893
Bonds payable - current redemption	1,325,000	1,280,000
Unearned revenues	332,023	193,559
Total Current Liabilities	2,072,564	2,173,890
Non-Current Liabilities:		
Bonds payable	28,915,000	30,240,000
Reoffering premium	1,601,708	1,678,420
Bond issue discount	(328,829)	(346,079)
Total Non-Current Liabilities	30,187,879	31,572,341
Total Liabilities	32,260,443	33,746,231
Net Position:		
Net investment in capital assets	5,726,030	5,076,694
Restricted for debt service	1,429,192	1,320,324
Restricted for capital projects	1,447,700	1,359,582
Unrestricted	4,174,767	3,845,423
Total Net Position	12,777,689	11,602,023
Total Liabilities and Net Position	\$ 45,038,132	\$ 45,348,254

See notes to Financial Statements

SOUTHMOST REGIONAL WATER AUTHORITY
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
For Years Ended September 30, 2016 and 2015

	2016	2015
Operating Revenues:		
Member assessments	\$ 6,622,653	\$ 6,185,810
Total Operating Revenues	6,622,653	6,185,810
Operating Expenses:		
Professional fees	10,000	10,000
Director's bonds	1,010	1,040
Legal fees	7,040	12,195
Meeting expenses	3,966	3,980
Utilities	1,059,645	923,081
Other expenses	2,407,859	2,173,222
Depreciation expense	931,124	864,865
Total Operating Expenses	4,420,644	3,988,383
Operating Income	2,202,009	2,197,427
Non-Operating Revenues (Expenses):		
Non-operating revenues (expenses)	(35,701)	(7,413)
Interest from investments	38,350	25,277
Amortized regulatory asset	(15,889)	(15,889)
Interest expense	(1,013,103)	(967,176)
Net Non-Operating Revenues (Expenses)	(1,026,343)	(965,201)
Change in net position	1,175,666	1,232,226
Net position at beginning of year	11,602,023	10,369,797
Net position at end of year	\$ 12,777,689	\$ 11,602,023

See notes to Financial Statements

SOUTHMOST REGIONAL WATER AUTHORITY
STATEMENTS OF CASH FLOW
For Years Ended September 30, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Cash Flows from Operating Activities:		
Cash received from members	\$ 7,347,939	\$ 7,253,921
Cash paid for services	(3,805,783)	(3,414,777)
Net cash provided by Operating Activities	<u>3,542,156</u>	<u>3,839,144</u>
Cash Flows from Capital and Related Financing Activities:		
Principal paid on debt	(1,280,000)	(1,240,000)
Interest paid on debt	(1,016,734)	(970,002)
Acquisition of capital assets	(667,973)	(1,142,694)
Net cash (used) by Capital and Related Financing Activities	<u>(2,964,707)</u>	<u>(3,352,696)</u>
Cash Flows from Investing Activities:		
Interest received	38,350	25,277
Purchase of investments	(3,678,732)	(3,586,104)
Sales of investments	3,599,408	2,529,416
Net cash (used) by Investing Activities	<u>(40,974)</u>	<u>(1,031,411)</u>
Net increase (decrease) in cash	536,475	(544,963)
Cash and cash equivalents at beginning of year	3,133,098	3,678,061
Cash and cash equivalents at end of year	<u>\$ 3,669,573</u>	<u>\$ 3,133,098</u>
Reconciliation of Cash and Cash Equivalents:		
Cash - unrestricted	\$ 211,210	\$ 176,940
Cash - restricted	443,109	329,079
Pooled investments - unrestricted	3,015,254	2,627,079
Total cash	<u>\$ 3,669,573</u>	<u>\$ 3,133,098</u>
Reconciliation of Operating Income to Net Cash Provided by Operating Activities:		
Operating income	\$ 2,202,009	\$ 2,197,427
Adjustments:		
Depreciation expense	931,124	864,865
Non-operating revenues (expenses)	(35,701)	(7,413)
Changes in assets and liabilities:		
Decrease (increase) in receivables	586,822	1,067,603
Decrease (increase) in prepaids	597	(8,886)
Increase (decrease) in accounts payable	(281,159)	(274,960)
Increase (decrease) in unearned revenues	138,464	508
Net cash provided by Operating Activities	<u>\$ 3,542,156</u>	<u>\$ 3,839,144</u>

See notes to Financial Statements

SOUTHMOST REGIONAL WATER AUTHORITY

Notes to the Financial Statements

September 30, 2016 and 2015

Note 1 – Nature of Business

The Southmost Regional Water Authority (“Authority”), a component unit of the Public Utilities Board of the City of Brownsville, is a conservation and reclamation district created pursuant to Article XVI, Section 59, of the Texas Constitution and the Act of June 12, 1981, 67th Leg., Ch. 511, 1981 Tex. Gen. Laws 2196 (the “Enabling Act” or the “Act”). The Authority will provide treated water to various areas of Cameron County.

Note 2 – Summary of Significant Accounting Policies

A summary of the significant accounting policies consistently applied in the preparation of the financial statements follows:

1. Basis of Presentation and Accounting

The Authority’s financial statements are presented on the accrual basis in accordance with accounting principles generally accepted in the United States of America. The Authority applies all Governmental Accounting Standards Board (GASB) pronouncements.

The Authority’s financial statements are also presented following the requirements of the *Water District Financial Management Guide* issued by the Texas Commission on Environmental Quality and effective for fiscal years ending after June 15, 2004.

The accounting records are organized on the fund accounting concept. The Authority operates under one enterprise fund.

2. Investments

Statutes authorize the Authority to invest in obligations of the United States or its agencies and instrumentalities; direct obligations of the State of Texas or its agencies; obligations of states, agencies, counties, cities, and other political subdivisions of any state rated not less than A or its equivalent; certificates of deposit; prime domestic bankers’ acceptances; certain commercial paper, certain mutual funds; and fully collateralized repurchase agreements.

3. Restricted Assets

Certain proceeds of the Authority’s revenue bonds are classified as restricted assets on the balance sheet because they are maintained in separate bank accounts and their use is limited by applicable bond covenants.

4. Capital Assets

Capital assets, which include property, plant, equipment, and infrastructure assets, are reported in the applicable columns in the financial statements. All capital assets are valued at historical cost or estimated historical cost if actual historical cost is not available. Interest incurred during the construction phase of capital assets is included in the capitalized value of the assets constructed. Capital assets are defined by the Authority as assets with an initial, individual cost of more than \$5,000 and an estimated useful life in excess of eighteen months.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets. The following estimated useful lives are used for depreciation purposes in 2016 and 2015.

<u>Classification</u>	<u>Range of lives</u>
Water plant-in-service	30 years
Buildings	33 years
Improvements other than buildings	25 to 50 years
Equipment	10 to 50 years

SOUTHMOST REGIONAL WATER AUTHORITY

Notes to the Financial Statements

September 30, 2016 and 2015

Note 2 – Summary of Significant Accounting Policies - Continued

5. Budget

An annual budget is created for the Authority each year. As required by the Authority's bond indenture, the proposed Annual System Budget shall be delivered to the Participating Customers at least 75 days prior to the beginning of the fiscal year. After consultation with the participants, the final budget must be approved not less than 30 days prior to the beginning of the fiscal year.

6. Use of Estimates

The preparation of the financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

7. Amortization

Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the straight line method.

8. Revenue Recognition

The Authority recognizes revenue by billing the members their percentage allocation of the operations and maintenance expenses and the debt service requirements, in advance, on an annual basis.

9. Cash and Cash Equivalents

For purposes of the Statements of Cash Flows, the Authority considers money market accounts, certificates of deposit, and investments with original maturities of three months or less from the date of acquisition to be cash equivalents.

10. Deferred Inflows of Resources

GASB Concept Statement No. 4, *Communication Methods in General Purpose External Financial Reports That Contain Basic Financial Statements*, provided definitions for elements in the financial statements. Deferred inflows of resources are the acquisition of net assets applicable to a future reporting period. GASB Statement No. 63 established guidance for reporting this element on the statement of net position, and GASB Statement No. 65 establishes accounting and financial reporting standards that reclassify, as deferred inflows of resources, certain items that were previously reported as liabilities. The Authority had no deferred inflows of resources to report at September 30, 2016 and 2015.

11. Deferred Outflows of Resources

Deferred outflows of resources are the consumption of net position applicable to a future reporting period, as defined in GASB Concept Statement No. 4. GASB Statement No. 63 establishes guidance for reporting this element on the statement of net position and GASB Statement No. 65 establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources, certain items that were previously reported as assets.

For current and advance refundings of debt, the difference between the reacquisition price and the net carrying amount of the old debt is recorded as unamortized reacquisition costs and reported as deferred outflows of resources. These amounts are amortized as components of interest expense over the shorter of

SOUTHMOST REGIONAL WATER AUTHORITY

Notes to the Financial Statements

September 30, 2016 and 2015

Note 2 – Summary of Significant Accounting Policies - Continued

11. Deferred Outflows of Resources– Continued

the remaining life of the refunding or the refunded debt. At September 30, 2016, and September 30, 2015, reacquisition costs totaled \$0.93 million and \$0.98 million, respectively.

12. Regulatory Basis Assets

The Authority is a blended component unit of the Public Utilities Board of the City of Brownsville (Brownsville PUB), therefore the Authority made the same election as the Brownsville PUB to establish a regulatory asset for the debt issuance costs in accordance with regulated operations under GASB Statement No. 62. The debt issuance costs would otherwise have been expensed upon implementation of GASB Statement No. 65.

13. Current Year GASB Statement Implementations

In fiscal year 2016, the Authority implemented the following GASB statements:

GASB Statement No. 72 *Fair Value Measurement and Application*, defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at a measurement date. Statement 72 requires that investments should generally be measured at fair value, with certain investments, such as short-term money market instruments, being specifically excluded from the requirement. Disclosures required by the standard include a description of the inputs and methods used to measure fair value. The adoption of Statement 72 resulted in additional footnote disclosures describing assets and liabilities reported at fair value and the valuation technique used to determine fair value.

GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, provides guidance for two new recognized categories of authoritative GAPP and addresses the use of authoritative and non-authoritative literature in the event that the accounting treatment for a transaction or other event is not specified within a source of authoritative GAAP. Implementation of this guidance did not have any significant impact on the Authority's financial statements.

GASB Statement No. 79, *Certain External Investment Pools and Pool Participants*, was issued to address how certain investment pool transactions are reported in response to anticipated changes in a U.S. Securities and Exchange Commission (SEC) rule that was previously included in GASB literature by reference. This Statement did not have a significant impact on the Authority's financial reporting.

In fiscal year 2015, there were no new GASB statements the Authority implemented.

14. Comparative Data/Reclassification

Comparative total data for the prior year have been presented in the accompanying financial statements in order to provide an understanding of changes in the Authority's financial position and operations. Also, certain amounts presented in the prior year data have been reclassified in order to be consistent with the current year's presentation

Note 3 – Deposits and Investments

The Authority's deposits and investments are insured by federal depository insurance or collateralized by financial institutions by governmental securities held in the Authority's name. The Authority's deposits and investments were entirely covered by the Federal Deposit Insurance Corporation. On December 14, 2015, the Authority approved a revised Investment Policy for its investments.

The carrying value of deposits with financial institutions approximates fair value.

SOUTHMOST REGIONAL WATER AUTHORITY

Notes to the Financial Statements

September 30, 2016 and 2015

Note 3 – Deposits and Investments – Continued

Interest rate risk deposits – In accordance with the Authority’s Investment Policy, the weighted average to maturity for the Authority’s portfolio is less than 270 days. The Authority’s cash deposit accounts have no fixed maturities. Therefore, the weighted average maturity in terms of years for the cash deposits is not applicable.

The Authority invests in TexPool, TexasDAILY, and TexStar to provide its liquidity needs. These pools are structured somewhat like money market mutual funds and allow shareholders the ability to deposit or withdraw funds on a daily basis. These pools are rated AAAm and must maintain a dollar weighted average maturity not to exceed a 60-day limit. At September 30, 2016, TexPool, TexasDAILY, and TexStar had a weighted average maturity of 45 days, 55 days, and 41 days respectively. The Authority considers the holdings in these funds to have a weighted average maturity of one day, due to the fact that the share position can usually be redeemed each day at the discretion of the shareholder, unless there has been a significant change in value.

Credit risk deposits – The Authority identifies and manages credit risks by following its adopted Investment Policy. The Authority implements its investment strategy, establishes and monitors compliance with investment policies and procedures, and consistently monitors prudent risk controls.

Custodial credit risk deposits – In accordance with the Authority’s Investment Policy, the financial institution must collateralize deposits with a minimum of 102% of the market value of the principal portion. The Authority signed an agreement with its financial institution pledging the Authority’s funds to a minimum of 102% of the market value of the principal portion.

As of September 30, the Authority had the following investments:

	September 30, 2016		
	Amount	Weighted Avg Maturity (days)	Rating
U.S. Treasury Note	\$ 554,629	46	AAAm
Money Market Mutual Funds	252,681	1	AAAm
Certificate of Deposit	1,164,000	39	A1P1
Local Government Investment Pools	3,560,989	1	AAAm
Total	\$ 5,532,299		

	September 30, 2015		
	Amount	Weighted Avg Maturity (days)	Rating
U.S. Treasury Note	\$ 554,629	90	AAAm
Money Market Mutual Funds	200,887	1	AAAm
Certificate of Deposit	675,000	37	A1P1
Local Government Investment Pools	3,634,283	1	AAAm
Total	\$ 5,064,799		

Interest risk investments – In accordance with the Authority’s Investment Policy, the investment pool shall provide daily liquidity and may be utilized as a competitive yield alternative to fixed maturity investment. The maximum dollar weighted maturity allowed shall be no greater than 90 days. The Authority manages exposure to fair value losses resulting from rising interest rates by limiting the portfolio’s weighted average maturity to two years. The Authority invests in money market and treasury money market funds that have no fixed maturities; therefore, the weighted average maturity in terms of years is not applicable.

SOUTHMOST REGIONAL WATER AUTHORITY

Notes to the Financial Statements

September 30, 2016 and 2015

Note 3 – Deposits and Investments – Continued

Credit risk investments – In accordance with the Authority’s Investment Policy, investment pools must be rated no lower than AAA or AAA-m with a weighted average maturity no greater than 90 days and any other obligations shall be rated “A” or better. For FY 2016 and FY 2015, the Authority managed exposure to credit risk by limiting its fixed income investments to a rating of “A” or better. The Authority held no investments with a rating below AA.

Concentration of credit risk investments – In accordance with its investment policies, the Authority manages exposure to credit risk through diversification and by limiting its investments in each investment pool to 75%, 75% in money market funds, and 75% in government agencies. Risk is controlled by investing only in the safest types of securities as defined in its policy; by collateralization as required by law and through portfolio diversification by maturity and type.

Custodial credit risk investments - The Authority’s Investment Policy allows a third-party banking institution acceptable to and under contract with the Authority or by the Federal Reserve Bank to serve as custodian of Security Notes.

Fair Value measurement – The Authority records assets and liabilities in accordance with GASB Statement No. 72, *Fair Value Measurement and Application*, which determines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurement. The Authority’s fair value measurements are performed on a recurring basis.

As a basis for considering market participant assumptions in fair value measurements, Statement No. 72 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three levels:

- Level 1 – inputs are quoted prices (unadjusted) for identical assets or liabilities in active markets that a government can access at the measurement date. Equity securities and U.S. Government Treasury securities are examples of Level 1 inputs.
- Level 2 – inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. Government agency and mortgage-backed securities and certificates of deposit are examples of Level 2 inputs.
- Level 3 – inputs are unobservable inputs that reflect the Authority’s own assumptions about factors that market participants would use in pricing the asset or liability (including assumptions about risk).

The valuation technique the Authority uses to measure fair value is the market approach. This approach uses prices and other relevant information generated by market transactions involving identical or comparable assets, liabilities, or a group of assets and liabilities, and is applied consistently.

The following table presents fair value balances and their levels within the fair value hierarchy as of September 30, 2016. Investment balances presented exclude amounts related to money market mutual fund investments and 2a7-like external investment pools accounted for using amortized cost.

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SOUTHMOST REGIONAL WATER AUTHORITY

Notes to the Financial Statements

September 30, 2016 and 2015

Note 3 – Deposits and Investments – Continued

	September 30, 2016			
	Level 1	Level 2	Level 3	Total
Fair Value Investments				
U.S. Treasuries	\$ 554,629	\$ -	\$ -	\$ 554,629
Certificates of Deposit	-	1,164,000	-	1,164,000
Total fair value investments	\$ 554,629	\$ 1,164,000	\$ -	\$ 1,718,629

	September 30, 2015			
	Level 1	Level 2	Level 3	Total
Fair Value Investments				
U.S. Treasuries	\$ 554,629	\$ -	\$ -	\$ 554,629
Certificates of Deposit	-	675,000	-	675,000
Total fair value investments	\$ 554,629	\$ 675,000	\$ -	\$ 1,229,629

Note 4 – Related Party Transactions

As of September 30, 2016 and 2015 the Authority includes the territory located within the following cities:

Brownsville Public Utilities Board
 Valley Municipal Utility District No. 2
 City of Los Fresnos
 Brownsville Navigation District
 Town of Indian Lake

Territory may be added or removed from the Authority, in accordance with certain provisions. Each participant's governing body appoints an individual as a director of the Authority. The Board of Directors will exercise all powers of the Authority subject to some restrictions imposed by law and By-laws. The directors serve a two-year term of office beginning on June 1 of odd-numbered years. Each participating entity is accorded a percentage of interest.

The members' allocated portion is as follows:

Brownsville Public Utilities Board	92.91%
Valley Municipal Utility District No. 2	2.51%
City of Los Fresnos	2.28%
Brownsville Navigation District	2.10%
Town of Indian Lake	0.20%
	100.00%

SOUTHMOST REGIONAL WATER AUTHORITY

Notes to the Financial Statements

September 30, 2016 and 2015

Note 5 – Due From Other Governments

At September 30, 2016 and 2015 the Authority had the following outstanding accounts receivable:

	<u>September 30, 2016</u>	<u>September 30, 2015</u>
Due From – City of Los Fresnos	\$ 4,416	\$ 4,413
Due From – Town of Indian Lake	387	2,492
Due From – Brownsville Navigation District	-	4,065
Due From – Valley Municipal Utility District No. 2	4,861	4,858
Due From – Brownsville Public Utilities Board	<u>167,021</u>	<u>-</u>
Total Due from Members	176,685	15,828
Accounts Receivable – TWDB	-	771,369
Accounts Receivable – BOR	<u>17,841</u>	<u>-</u>
	<u>\$ 194,526</u>	<u>\$ 787,197</u>

Note 5 – Due From Other Governments - Continued

On December 7, 2009, the Authority issued \$13,090,000 in Water Supply Contract Revenue Bonds, Series 2009A and 2009B through the Texas Water Development Board (TWDB) Drinking Water State Revolving Fund. Funds were held by the TWDB and released through installments as project expenses were incurred. On June 6, 2013 TWDB released all remaining funds which were then deposited into an Escrow account with Wells Fargo Bank. The escrow account balance at September 30, 2015 was \$771,369 and at September 30, 2016 was \$0.

Note 6 – Net Position

Net position comprises the various net earnings from operating revenues, expenses, and contributions of capital. Net position represents the difference between assets plus deferred outflows of resources and liabilities.

Note 7 – Commitments and Contingencies

The Authority had \$309,960 and \$951,233 in construction commitments at September 30, 2016 and 2015, respectively.

Note 8 - Leases

The Authority initially entered into nineteen (19) ground lease agreements. Since then, the Authority purchased sixteen of the properties through a fee simple purchase. The Authority agreed to pay \$500.00 per annum per lease for the remaining leases. The rental will be prepaid annually. The total amount of the three remaining leases is \$1,500. So long as Lessee is not in default, the term of the lease may be extended (“extended term”), at the option of the Lessee, for up to thirty (30) years. The renewal of the extended term of the leases will be automatic unless a written notice is provided to the Lessor at least 180 days before the end of the primary term.

Note 9 – Bonds Payable

On December 12, 2002, the Authority issued Revenue Bonds Series 2002 for \$30,975,000. Proceeds of the Bonds financed the acquisition of right-of-way and real property interest, and the design, construction and equipping of 7.5 MGD brackish water desalination plant and a water conveyance system, along with all extensions, additions, enlargements, improvements, and modifications. Interest on the Series 2002 Bonds accrued from December 1, and was payable March 1, and each September 1 and March 1 thereafter until maturity or prior redemption.

SOUTHMOST REGIONAL WATER AUTHORITY

Notes to the Financial Statements

September 30, 2016 and 2015

Note 9 – Bonds Payable –Continued

On December 7, 2009, the Authority issued \$9,295,000 in Water Supply Contract Revenue Bonds, Series 2009A and \$3,795,000 in Water Supply Contract Revenue Bonds, Series 2009B through the Texas Water Development Board Drinking Water State Revolving Fund for the construction of a full scale Micro Filtration Pretreatment System. The Series 2009A bonds were issued at 0.0% interest with annual installments ranging from \$305,000 to \$310,000 through maturity in 2039. The Series 2009B bonds bear interest at a range from 0.10% to 4.25% with annual installments ranging from \$125,000 to \$270,000 through maturity in 2029.

Current Refunding

During FY 2014, the Authority issued \$13,530,000 in aggregate principal amount of Water Supply Contract Revenue Refunding Bonds, Series 2012 for an advance refunding of \$14,990,000 of the Series 2002 Revenue Bonds for the years 2013 through 2027. As a result, the refunded bonds are considered to be defeased and the liability has been removed from long-term debt. The reacquisition price exceeded the net carrying amount of the old debt by \$48,131. This amount together with \$423,630 of unamortized deferred amount from the prior refunding is being netted against the new debt and amortized through the year 2027. This advance refunding was undertaken to reduce total debt service payments and resulted in an economic gain (difference between the present values of the old debt and new debt service payments) of \$2,139,931.

Prior Year Defeasance of Debt

In prior years, the Authority has defeased various bond issues by creating separate irrevocable trust funds. New Debt has been issued and the proceeds have been used to purchase U.S. government securities that were placed in the trust funds. The investments and fixed earnings from the investments are sufficient to fully service the defeased debt until the debt is called or it matures. For financial reporting purposes, the debt has been considered defeased and therefore removed as a liability from long-term debt. As of September 30, 2016, the amount of defeased debt outstanding but removed from long-term debt amounted to \$0.

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SOUTHMOST REGIONAL WATER AUTHORITY

Notes to the Financial Statements

September 30, 2016 and 2015

Revenue bond balance and activity as of and for the year ending September 30, 2016 are as follows:

	<u>Balance at Oct. 1, 2015</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance at Sep. 30, 2016</u>	<u>Due Within One Year</u>
\$9,950,000 Water Supply Contract Revenue Refunding Bonds, Series 2006; due in remaining annual installments ranging from \$10,000 to \$1,845,000 through 2032 with interest rate ranging from 4.0% to 5.5%.	\$ 9,790,000	\$ -	\$ (25,000)	\$ 9,765,000	\$ 25,000
\$9,295,000 Revenue Bonds, Series 2009A; due in remaining annual installments ranging from \$305,000 to \$310,000 through 2039 with interest rate at 0.0%.	7,435,000	-	(310,000)	7,125,000	310,000
\$3,795,000 Revenue Bonds, Series 2009B; due in remaining annual installments ranging from \$125,000 to \$270,000 through 2029 with interest rate ranging from 0.10% to 4.25%.	2,950,000	-	(160,000)	2,790,000	165,000
\$13,530,000 Water Supply Contract Revenue Refunding Bonds, Series 2012; due in remaining annual installments ranging from \$700,000 to \$1,285,000 through 2027 with interest rate ranging from 3.0% to 5.0%	11,345,000	-	(785,000)	10,560,000	825,000
Total Long-Term Debt	<u>\$ 31,520,000</u>	<u>\$ -</u>	<u>\$ (1,280,000)</u>	<u>\$ 30,240,000</u>	<u>\$ 1,325,000</u>

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SOUTHMOST REGIONAL WATER AUTHORITY

Notes to the Financial Statements

September 30, 2016 and 2015

Note 9 – Bonds Payable –Continued

Revenue bond balance and activity as of and for the year ending September 30, 2015 are as follows:

	<u>Balance at Oct. 1, 2014</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance at Sep. 30, 2015</u>	<u>Due Within One Year</u>
\$9,950,000 Water Supply Contract Revenue Refunding Bonds, Series 2006; due in remaining annual installments ranging from \$10,000 to \$1,845,000 through 2032 with interest rate ranging from 4.0% to 5.5%.	\$ 9,810,000	\$ -	\$ (20,000)	\$ 9,790,000	\$ 25,000
\$9,295,000 Revenue Bonds, Series 2009A; due in remaining annual installments ranging from \$305,000 to \$310,000 through 2039 with interest rate at 0.0%.	7,745,000	-	(310,000)	7,435,000	310,000
\$3,795,000 Revenue Bonds, Series 2009B; due in remaining annual installments ranging from \$125,000 to \$270,000 through 2029 with interest rate ranging from 0.10% to 4.25%.	3,105,000	-	(155,000)	2,950,000	160,000
\$13,530,000 Water Supply Contract Revenue Refunding Bonds, Series 2012; due in remaining annual installments ranging from \$700,000 to \$1,285,000 through 2027 with interest rate ranging from 3.0% to 5.0%	12,100,000	-	(755,000)	11,345,000	785,000
Total Long-Term Debt	<u>\$ 32,760,000</u>	<u>\$ -</u>	<u>\$ (1,240,000)</u>	<u>\$ 31,520,000</u>	<u>\$ 1,280,000</u>

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SOUTHMOST REGIONAL WATER AUTHORITY

Notes to the Financial Statements

September 30, 2016 and 2015

Note 9 – Bonds Payable –Continued

Principal and interest amounts due for each of the next five years and thereafter to maturity are:

Year ending September 30:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2017	\$ 1,325,000	\$ 999,141	\$ 2,324,141
2018	1,350,000	977,389	2,327,389
2019	1,425,000	929,639	2,354,639
2020	1,465,000	873,264	2,338,264
2021	1,515,000	819,269	2,334,269
2022-2026	8,515,000	3,180,951	11,695,951
2027-2031	10,325,000	1,506,606	11,831,606
2032-2036	3,395,000	77,490	3,472,490
2037-2041	925,000	-	925,000
	<u>\$ 30,240,000</u>	<u>\$ 9,363,749</u>	<u>\$ 39,603,749</u>

Note 10 – Unearned Revenues

Member assessments collected in advance are deferred and recognized when the assessments are earned. At September 30, 2016, and 2015, unearned revenue totaled \$332,023, and \$193,559, respectively.

Note 11 – Capital Assets

Changes in the Authority's capital assets for the year ending September 30, 2016 were as follow:

	<u>Balance at 10/01/2015</u>	<u>Additions</u>	<u>Deletions</u>	<u>Reclassifications</u>	<u>Balance at 09/30/2016</u>
Capital assets, not being depreciated:					
Land	\$ 1,802,935	\$ -	\$ -	\$ -	\$ 1,802,935
Construction in progress	13,157,541	556,784	-	(13,637,281)	77,044
Total capital assets not being depreciated	<u>14,960,476</u>	<u>556,784</u>	<u>-</u>	<u>(13,637,281)</u>	<u>1,879,979</u>
Capital assets being depreciated:					
Plant	11,297,577	-	-	807,433	12,105,010
Buildings and structures	14,174,956	18,026	-	2,602,283	16,795,265
Improvements	-	-	-	2,731,230	2,731,230
Equipment	5,941,902	93,163	-	7,496,335	13,531,400
Total capital assets being depreciated	<u>31,414,435</u>	<u>111,189</u>	<u>-</u>	<u>13,637,281</u>	<u>45,162,905</u>
Total capital assets	46,374,911	667,973	-	-	47,042,884
Less accumulated depreciation for:					
Plant	(2,735,588)	(275,051)	-	-	(3,010,639)
Buildings and structures	(4,096,965)	(405,283)	-	-	(4,502,248)
Improvements	-	(9,104)	-	-	(9,104)
Equipment	(2,040,299)	(241,686)	-	-	(2,281,985)
Total accumulated depreciation	<u>(8,872,852)</u>	<u>(931,124)</u>	<u>-</u>	<u>-</u>	<u>(9,803,976)</u>
Capital assets, net	<u>\$ 37,502,059</u>	<u>\$ (263,151)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 37,238,908</u>

SOUTHMOST REGIONAL WATER AUTHORITY

Notes to the Financial Statements

September 30, 2016 and 2015

Note 11 – Capital Assets - Continued

Changes in the Authority’s capital assets for the year ending September 30, 2015 were as follow:

	Balance at 10/01/2014	Additions	Deletions	Reclassifications	Balance at 09/30/2015
Capital assets, not being depreciated:					
Land	\$ 1,802,935	\$ -	\$ -	\$ -	\$ 1,802,935
Construction in progress	12,014,680	1,142,861	-	-	13,157,541
Total capital assets not being depreciated	<u>13,817,615</u>	<u>1,142,861</u>	<u>-</u>	<u>-</u>	<u>14,960,476</u>
Capital assets being depreciated:					
Plant	11,297,577	-	-	-	11,297,577
Buildings and structures	14,174,956	-	-	-	14,174,956
Equipment	5,941,902	-	-	-	5,941,902
Total capital assets being depreciated	<u>31,414,435</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>31,414,435</u>
Total capital assets	45,232,050	1,142,861	-	-	46,374,911
Less accumulated depreciation for:					
Plant	(2,628,399)	(270,624)	(167)	163,602	(2,735,588)
Buildings and structures	(3,554,946)	(394,573)	-	(147,446)	(4,096,965)
Equipment	(1,824,475)	(199,668)	-	(16,156)	(2,040,299)
Total accumulated depreciation	<u>(8,007,820)</u>	<u>(864,865)</u>	<u>(167)</u>	<u>-</u>	<u>(8,872,852)</u>
Capital assets, net	<u>\$ 37,224,230</u>	<u>\$ 277,996</u>	<u>\$ 167</u>	<u>\$ -</u>	<u>\$ 37,502,059</u>

Note 12 – Risk Management

The Authority is exposed to various risks of loss including those related to torts, theft or destruction of assets, errors and omissions, and natural disasters. The Authority purchases general liability and property insurance coverage to provide protection in the event of large and/or catastrophic losses. In addition, the Authority purchases Directors & Officers (D&O), Public Officials and auto liability insurance coverage. Independent Insurance Consultant, Gallagher Benefit Services, Inc., was contracted for consulting services in FY 2015. Gallagher Benefits Services has determined adequate insurance retentions for the Authority based on insurable values and the market for each line of coverage.

The insurable value for the Authority in FY 2015 was \$40,196,111 and increased to \$40,726,700 for FY 2016. The premium for FY 2016 was \$71,161 and \$67,894 for FY 2015.

Note 13 – Pending GASBs

As of September 30, 2016, the Governmental Accounting Standards Board (GASB) had issued statements not yet implemented by the Authority. The statements that have been evaluated for financial statement impact are as follows:

- GASB Statement No. 74, *Financial Reporting for Post-Employment Benefit Plans Other Than Pension Plans*;
- GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*;
- GASB Statement No. 77, *Tax Abatement Disclosures*;
- GASB Statement No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*;

SOUTHMOST REGIONAL WATER AUTHORITY

Notes to the Financial Statements

September 30, 2016 and 2015

Note 13 - Pending GASBs – Continued

- GASB Statement No. 80, *Blending Requirements for Certain Component Units – an amendment of GASB Statement No. 14*

Management has evaluated these pending GASB statements, and has determined there to be no financial statement impact to the Authority.

APPENDIX B
EXCERPTS FROM THE
PUBLIC UTILITIES BOARD OF THE CITY OF BROWNSVILLE, TEXAS
ANNUAL FINANCIAL REPORT
For the Year Ended September 30, 2016

The information contained in this Appendix consists of excerpts from the Public Utilities Board of the City of Brownsville, Texas Annual Financial Report for the Year Ended September 30, 2016, and is not intended to be a complete statement of the Board's financial condition. Reference is made to the complete Report for further information.

NOTE: The Southmost Regional Water Authority (the "Authority") is a component unit of the Public Utilities Board of the City of Brownsville, Texas. Excerpts from a separate Annual Financial Report of the Authority are attached to this Official Statement as Appendix A.

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Public Utilities Board of the City of Brownsville, Texas

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities of the Public Utilities Board of the City of Brownsville, Texas ("Public Utilities Board"), a component unit of the City of Brownsville, Texas, as of and for the year ended September 30, 2016, and the related notes to the financial statements, which collectively comprise the Public Utilities Board'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 audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit 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 entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used

and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities of the Public Utilities Board as of September 30, 2016, and the respective changes in financial position, and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Prior Period Financial Statements

The financial statements of the Public Utilities Board as of and for the year ended September 30, 2015, were audited by other auditors whose report dated January 26, 2016, expressed an unmodified opinion on those statements.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 7-14 and the schedule of changes in net pension liability and related ratios, schedule of contributions, and schedule of funding progress on pages 64-67 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required 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 basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Public Utilities Board's basic financial statements. The introductory section and statistical section are presented for purposes of additional analysis and are not a required part of the basic financial statements. The schedule of expenditures of state awards is presented for purposes of additional analysis as required by the *State of Texas Single Audit Circular*, and is also not a required part of the basic financial statements.

The schedule of expenditures of state awards is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of state awards is fairly stated in all material respects in relation to the basic financial statements as a whole.

The introductory and statistical sections have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on them.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated March 10, 2017, on our consideration of the Public Utilities Board's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Public Utilities Board's internal control over financial reporting and compliance.

Carr, Riggs & Ingram, L.L.C.

CARR, RIGGS & INGRAM, LLC

Brownsville, Texas

March 10, 2017

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MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the Public Utilities Board of the City of Brownsville, Texas' (Public Utilities Board) annual financial report presents management's analysis of its financial performance during the fiscal years that ended on September 30, 2016 and 2015. Please read it in conjunction with the financial statements that follow this section.

Overview of Annual Financial Report

The financial statements report information about the Public Utilities Board using full accrual accounting methods as utilized by similar business activities in the private sector. The financial statements include the statements of net position, the statements of revenues, expenses, and changes in net position, the statements of cash flows, and the notes to the financial statements.

The Statements of Net Position present the financial position of the Public Utilities Board on a full accrual, historical cost basis. The Statements of Net Position present information on all of the Public Utilities Board's assets and liabilities, with the difference reported as net position. Over time, increases and decreases in net position are one indicator of whether the financial position of the Public Utilities Board is improving or deteriorating.

While the Statements of Net Position provide information about the nature and amount of resources and obligations at year-end, the Statements of Revenues, Expenses, and Changes in Net Position present the results of the business activities over the course of the fiscal year and information as to how the net position changed during the year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. This statement also provides certain information about the Public Utilities Board's recovery of its costs.

The Statements of Cash Flows present changes in cash and cash equivalents, resulting from operating, financing, and investing activities. These statements present cash receipts and cash disbursement information, without consideration of the earnings event, when an obligation arises, or depreciation of capital assets.

The notes to the financial statements provide required disclosures and other information that are essential to a full understanding of material data provided in the statements. The notes present information about the Public Utilities Board's accounting policies, significant account balances and activities, material risks, obligations, commitments, contingencies and subsequent events.

Financial Analysis

The following condensed financial information and other selected information serve as the key financial data and indicators for management monitoring and planning.

Financial Condition

One of the most important questions asked about the Public Utilities Board's finances is, "Is the Public Utilities Board, as a whole, better off or worse off as a result of the year's activities?" The Statement of Net Position and the Statement of Revenues, Expenses, and Changes in Net Position report information about the Public Utilities Board's activities in a way that will help answer this question. These two statements report the net position of the Public Utilities Board and changes in them. Increases or decreases in net position over time is a useful indicator of whether the Public Utilities Board's financial health is improving or deteriorating.

The Public Utilities Board's assets plus deferred outflows of resources exceeded liabilities and deferred inflows of resources by \$483.2 million at the close of fiscal year 2016. Net position increased by \$7.1 million or 1.5% compared to the previous fiscal year. This increase in net position is a good indicator that the Public Utilities

Board's financial health continues to progress. Net position in net investment in capital assets totaled \$311 million and \$308 million for fiscal years 2016 and 2015, respectively.

The restricted net position of \$143.7 million and \$117.1 million for fiscal years 2016 and 2015, respectively, is subject to external restrictions on how it may be used. The remaining balances of unrestricted net position, totaling \$28.8 million and \$51.0 million for fiscal years 2016 and 2015, respectively, may be used to meet the Public Utilities Board's ongoing obligations. The Public Utilities Board's changes in net position are further analyzed below in Table A-1 and Table A-2.

The City Commission adopted a five-year rate proposal on December 17, 2012 that included increases sufficient to meet projected costs and debt coverage requirements. Rates were increased effective April 1, 2013 for the electric utility and subsequent rate increases have effective dates of October 1, 2013, October 1, 2014, October 1, 2015 and October 1, 2016.

While affordability is always a concern, the rate increases implemented will allow the Public Utilities Board to continue investing in core service areas including energy reliability, water quality, and wastewater treatment services.

Net Position

A summary of the Public Utilities Board's Statements of Net Position is presented in Table A-1.

TABLE A-1
STATEMENTS OF NET POSITION
September 30, 2016, 2015 and 2014
(in millions of dollars)

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Current and other assets	\$ 238.8	\$ 218.8	\$ 207.0
Capital assets	<u>641.1</u>	<u>644.9</u>	<u>639.8</u>
Total assets	<u>879.9</u>	<u>863.7</u>	<u>846.8</u>
Deferred outflows of resources	<u>32.0</u>	<u>24.3</u>	<u>17.2</u>
Total assets plus deferred outflows of resources	<u>911.9</u>	<u>888.0</u>	<u>864.0</u>
Current liabilities	52.0	45.4	61.5
Long-term liabilities	<u>374.0</u>	<u>364.5</u>	<u>343.6</u>
Total liabilities	<u>426.0</u>	<u>409.9</u>	<u>405.1</u>
Deferred inflows of resources	<u>2.7</u>	<u>2.0</u>	<u>1.3</u>
Total liabilities plus deferred inflows of resources	<u>428.7</u>	<u>411.9</u>	<u>406.4</u>
Net position:			
Investment in capital assets	310.7	308.0	297.5
Restricted	143.7	117.1	104.0
Unrestricted	<u>28.8</u>	<u>51.0</u>	<u>56.1</u>
Total net position	<u>\$ 483.2</u>	<u>\$ 476.1</u>	<u>\$ 457.6</u>

The Public Utilities Board's net position as of September 30, 2016 increased 1.5% to \$483.2 million and increased 4.0% to \$476.1 million as of September 30, 2015. The increases in 2016 and 2015 are attributed to income earned on operations of the utility system and to receipt of grant funds reported as capital contributions.

In fiscal year 2015, the Public Utilities Board adopted and implemented GASB Statement No. 68, *Accounting and Financial Reporting for Pensions an amendment of GASB Statement No. 27* and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date, an amendment of GASB Statement No. 68*, and recorded a prior period adjustment to reflect the effects of the guidance. The net effect of the transaction caused the restatement of net position previously recorded in 2014.

TABLE A-2
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
 For Fiscal Years Ended September 30, 2016, 2015 and 2014
 (in millions of dollars)

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Operating revenues - sales	\$ 202.7	\$ 202.9	\$ 187.2
Investment and interest income	1.2	0.8	0.5
Non-Operating revenue	0.5	1.6	1.2
Total revenues	<u>204.4</u>	<u>205.3</u>	<u>188.9</u>
Purchased power and fuel	66.0	65.2	66.9
Personnel services	49.1	33.3	32.8
Materials and supplies	7.0	7.3	7.4
Repairs and maintenance	2.7	3.0	3.7
Contractual and other services	24.4	21.5	19.2
Depreciation expense	29.1	29.5	28.4
Interest expense	14.7	14.5	15.1
Loss on disposition of capital assets	1.0	3.6	1.0
Payments to the City of Brownsville	9.8	9.0	7.6
Total expenses	<u>203.8</u>	<u>186.9</u>	<u>182.1</u>
Changes in net position before capital contributions	0.6	18.4	6.8
Capital contributions	6.5	13.0	18.7
Change in net position	<u>7.1</u>	<u>31.4</u>	<u>25.5</u>
Beginning net position	476.1	457.6	432.1
Prior period adjustment	-	(12.9)	-
Beginning net position, as restated	<u>476.1</u>	<u>444.7</u>	<u>432.1</u>
Ending net position	<u>\$ 483.2</u>	<u>\$ 476.1</u>	<u>\$ 457.6</u>

While the Statements of Net Position show the yearly change in financial position, the Statements of Revenues, Expenses, and Changes in Net Position provides answers as to the nature and source of these changes. In 2016, the Public Utilities Board had a decrease in operating revenues of \$0.2 million due to a combination of utility system revenue increases and decreases. Operating revenues for fiscal year 2016 decreased only slightly from the prior year. Investment earnings increased \$0.4 million from fiscal year 2015 and \$0.3 million from fiscal year 2014. Non-operating revenue decreased \$1.1 million from prior year. Capital contributions decreased by \$6.5 million. Capital contributions may vary greatly from year to year based on grant awards and the cyclical nature of housing, commercial and industrial development in the City.

Some notable changes in expenses for 2016 were increases in personnel services of \$15.8 million, an increase in purchased power and fuel of \$0.8 million, and a decrease in the loss on disposition of capital assets of \$2.6 million. The increase in personnel services can be attributed to an increase in pension expense and benefits. Overall, the Public Utilities Boards net position increased \$7.1 million in 2016.

In 2015, the Public Utilities Board had an increase in operating revenues of \$15.7 million due to a combination of utility system revenue increases and decreases. Some notable changes in operating revenues for 2015 include an increase of \$20.1 million in residential and commercial electric operating revenues due to increases in the Fuel Purchased Energy Charge (FPEC) to recover increased purchased power and fuel requirements; rate increases that became effective on October 1, 2014; an increase of \$1.5 million in sales for resale and other ancillary services; and a decrease of \$250,000 in water and wastewater operating revenues due to decreased customer consumption. In 2015 the Public Utilities Board received an insurance settlement in the amount of \$1.1 million for plant outages in 2012. Capital contributions decreased by \$5.7 million. Capital contributions may vary greatly from year to year based on grant awards and the cyclical nature of housing, commercial and industrial development in the City

Some notable changes in expenses for 2015 were increases in contractual and other services of \$2.3 million; an increase in loss on disposition of capital assets of \$2.6 million; and an increase in payments to the City of Brownsville of \$1.4 million. Overall, the Public Utilities Boards net position increased \$18.5 million in 2015.

Capital Assets

At the end of 2016 and 2015, the Public Utilities Board's net capital assets in Table A-3 of \$641.1 million and \$644.9 million, respectively. This represents a 0.6% or a \$3.8 million decrease, and a 0.8% or a \$5.1 million increase, respectively, for fiscal year 2016 and 2015.

TABLE A-3
CAPITAL ASSETS
September 30, 2016, 2015 and 2014
(in millions of dollars)

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Land	\$ 27.6	\$ 26.1	\$ 25.2
Plant	746.3	737.8	715.2
Buildings and structures	92.4	89.9	75.2
Improvements other than buildings	48.6	45.9	45.9
Equipment	133.0	125.1	119.3
Construction in progress	88.7	91.3	112.0
Subtotal	<u>1,136.6</u>	<u>1,116.1</u>	<u>1,092.8</u>
Less accumulated depreciation	<u>(495.5)</u>	<u>(471.2)</u>	<u>(453.0)</u>
Net capital assets	<u>\$ 641.1</u>	<u>\$ 644.9</u>	<u>\$ 639.8</u>

The following is a summary of some of the major improvements to the utility system during fiscal year 2016:

- \$2.0 million in Electric Steam Production Projects
- \$5.1 million in Electric Transmission and Distribution Projects
- \$0.07 million in Electric General Projects
- \$1.2 million in Water Distribution and Supply Projects
- \$2.4 million in Wastewater Collection and Pumping Projects
- \$1.7 million in General Facility Projects

The following is a summary of some of the major improvements to the utility system during fiscal year 2015:

- \$2.6 million in Electric Steam Production Projects
- \$2.8 million in Electric Transmission and Distribution Projects
- \$1.8 million in Electric General Projects
- \$4.1 million in Water Distribution and Supply Projects
- \$33.1 million in Wastewater Collection and Pumping Projects
- \$0.3 million in General Facility Projects

At September 30, 2016 and 2015, the Public Utilities Board had contractual obligations totaling approximately \$13,236,008 and \$18,287,773, respectively, for utility plant expansion and improvements. Funding of these amounts will come from available revenues of the Public Utilities Board and restricted funds.

Additional information on the Public Utilities Board’s capital assets can be found in Note 3 to the financial statements on pages 34-35 of this report.

Debt Administration

The Public Utilities Board’s outstanding debt is summarized as follows:

TABLE A-4
OUTSTANDING DEBT
September 30, 2016, 2015 and 2014
(in millions of dollars)

	2016	2015	2014
Revenue bonds, net	\$ 345.6	\$ 356.2	\$ 349.8
Commercial Paper	7.0	-	13.0
Total	\$ 352.6	\$ 356.2	\$ 362.8

Additional information on the Public Utilities Board's debt can be found in Notes 5 and 6 on pages 36-45 of this report.

The Public Utilities Board continues to have insured bond ratings from the national rating agencies. Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc., has assigned short term insured ratings of A-1+, and Fitch Ratings has assigned short term insured ratings of F1+. The Public Utilities Board underlying ratings on its senior lien debt are "A2", "A+" and "A+" by Moody's, Standard & Poor's, and Fitch Ratings, respectively.

Revenue bonds outstanding at September 30, 2016 and 2015 were \$308,804,000 and \$325,352,000, respectively. Interest on bonds is due semi-annually on March 1 and September 1, and the principal is due annually on September 1. Revenue bond debt service coverage for the Public Utilities Board's priority and second lien obligations was calculated at 2.40 and 2.78 times at September 30, 2016 and 2015, respectively.

On January 15, 2003, the Public Utilities Board sold \$76,400,000 variable rate demand bonds as series 2002A and 2002B Utility System Subordinate Lien Revenue and Refunding Bonds. The bonds' variable rate was synthetically fixed at 2.576% until 2008 utilizing a swap financing strategy. The City Commission of the City of Brownsville, Texas authorized the execution of a Rate Cap Agreement effective September 1, 2006 through September 1, 2011 to give an insurance against increasing short term rates. The Public Utilities Board executed an agreement with an eligible provider for a notional amount of \$41,880,000 with an interest rate cap of 4.50%. The notional amount of the original swap decreased to \$10,830,000 effective September 1, 2006 provided a synthetic fixed rate of 2.576%. Proceeds from the sale of the bonds were used to retire currently outstanding revenue bonds, to build, improve, extend, enlarge, and repair the system, and to pay costs of issuance of the bonds. On August 24, 2005, the Public Utilities Board sold \$163,725,000 in tax exempt bonds and \$56,855,000 in taxable bonds as part of a major debt restructuring. The tax exempt bonds, Series 2005A, provided proceeds to refund \$50,890,000 in Series 1995 outstanding obligations, \$50,000,000 in Series 2001A and \$50,000,000 in Series 2001B variable rate outstanding obligations, and \$7,250,000 in outstanding commercial paper notes, and provided \$20,000,000 in new money bonds. The taxable bonds, Series 2005B, provided proceeds to defease \$27,420,000 in Series 1992 outstanding obligations and \$22,120,000 in Series 1995 outstanding obligations.

On December 1, 2006 the Public Utilities Board issued \$601,000 City of Brownsville, Texas Utilities System Junior Lien Revenue Bonds, Series 2007 for the purpose of building, improving, extending, enlarging, and repairing the City's utilities system and to pay costs of issuance of the bonds.

The Public Utilities Board issued \$77,805,000 in aggregate principal amount of Utilities System Revenue Refunding Bonds, Series 2008. The refunding bonds provided proceeds to defease \$40,000,000 of Commercial Paper Notes, Series 2004, \$32,285,000 of the Series 2002A Utility System Subordinate Lien Revenue and Refunding Bonds, and \$13,415,000 of the Series 2002B Utility System Subordinate Lien Revenue and Refunding Bonds.

On February 28, 2011, the Public Utilities Board issued \$12,305,000 in Utilities System Revenue Refunding Bonds, Series 2011. The refunding bonds provided proceeds to refund \$6,270,000 of Junior Lien Exchange Revenue Refunding Bonds, Series 2005A and \$5,980,000 of Junior Lien Exchange Revenue Refunding Bonds, Series 2005B.

On September 25, 2012, the Public Utilities Board issued \$20,690,000 in Utility System Revenue Refunding Bonds, Series 2012. The refunding bonds had a closing date of October 18, 2012, and the proceeds plus \$5,275,000 in issuer contributions were used to defease \$24,450,000 of Commercial Paper notes.

On October 1, 2012, the Public Utilities Board issued \$840,000 in Utility System Junior Lien Revenue Bonds, Series 2012. Proceeds from sale of the Obligations will be used for the purpose of funding construction improvements to the wastewater system on the FM 511 – 802 Colonia Project.

On May 1, 2013, the Public Utilities Board issued \$118,185,000 in Utilities System Revenue Refunding Bonds, Series 2013. The refunding bonds provided proceeds to refund \$109,985,000 of Utility System Improvement and Refunding Bonds, Series 2005A. In addition, the proceeds provided funds of \$11,818,500 to make a cash deposit into the Debt Service Reserve Fund.

On July 15, 2015, the Public Utilities Board issued \$94,770,000 in Utilities System Revenue Refunding Bonds, Series 2015. The bonds provided proceeds to refund \$49,060,000 of Series 2005A Revenue Improvement & Refunding Bonds, \$27,815,000 of Series 2005B Revenue Refunding Bonds and \$5,480,000 of Series 2011 Revenue Refunding Bonds. In addition, the proceeds provided funds to defease \$20,000,000 in outstanding Commercial Paper Notes.

On May 15, 2016, the Public Utilities Board issued \$39,410,000 in Utilities System Revenue Refunding Bonds, Series 2016. The bonds, plus a premium of \$7,705,681, provided proceeds to refund \$42,505,000 of the Series 2008 Revenue Refunding Bonds.

The Public Utilities Board's participation in the Southmost Regional Water Authority's (the Authority) desalination plant project was complete and operational during 2005. The Authority successfully issued \$30,975,000 in Water Supply Contract Revenue Bonds during fiscal year 2003 and has expended approximately 100.0% of bond proceeds in the construction of the desalination plant. The Series 2002 bonds were issued with insured ratings of "Aaa" and "AAA" by Moody's Investor Services and Fitch Ratings, respectively. The underlying ratings on the bonds are "A2" and "A" by Moody's and Fitch, respectively. The Public Utilities Board total interest in the project is 92.91%. The Authority is considered a blended component unit of the Public Utilities Board. As a participating owner, the Public Utilities Board is obligated to contribute its percentage allocation of the Authority's debt service obligations and annual system budget. The Public Utilities Board's total 2016 and 2015 contributions to the Authority were \$6,155,725 and \$5,738,013, respectively. The Public Utilities Board's participation in the Authority's desalination project provides the City with an alternate, long-term, drought-resistant source of drinking water.

The Authority issued \$9,950,000 in aggregate principal amount of Water Supply Contract Revenue Refunding Bonds, Series 2006. The refunding bonds provided proceeds to defease \$9,360,000 of the Series 2002 Revenue Bonds for the years 2019 and from 2028 through 2032.

On December 7, 2009 the Authority issued \$9,295,000 in Water Supply Contract Revenue Bonds, Series 2009A and \$3,795,000 in Water Supply Contract Revenue Bonds, Series 2009B through the Texas Water Development Board Drinking Water State Revolving Fund for the construction of a full scale Micro Filtration Pretreatment System. The objective of this project is to achieve compliance with both existing and future maximum contaminant levels for arsenic in public drinking water by constructing a full scale Micro Filtration Pretreatment System prior to entering the existing reverse osmosis treatment process. An additional need is to control and reduce iron levels to eliminate complaints of colored water. Project objectives also include an additional 1.0 million gallons per day of capacity through upgrading certain pumps within the existing well field and adding one additional reverse osmosis train.

On September 26, 2012, the Southmost Regional Water Authority issued \$13,530,000 in Water Supply Contract Revenue Refunding Bonds, Series 2012. The refunding bonds had a closing date of October 18, 2012, and the proceeds plus the bond premium were used to defease \$14,990,000 of the Series 2002 Revenue Bonds for the years 2013 through 2027.

Request For Information

This financial report is designed to provide the reader with a general overview of the Public Utilities Board's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Chief Financial Officer, P.O. Box 3270, Brownsville, TX 78523-3270. This report is available on the Public Utilities Board's website – www.brownsville-pub.com.

FINANCIAL STATEMENTS

PUBLIC UTILITIES BOARD OF THE CITY OF BROWNSVILLE, TEXAS
(A Component Unit of the City of Brownsville, Texas)
Statements of Net Position
September 30, 2016 and 2015

Assets	2016	2015
Current assets:		
Cash and cash equivalents	\$ 13,866,339	\$ 17,388,130
Investments	32,902,513	33,272,295
Receivables:		
Fees and services, net of allowance for uncollectible accounts of \$426,041 and \$747,531 in 2016 and 2015, respectively	26,884,759	27,021,238
Intergovernmental	1,031,803	1,726,949
Accrued interest receivable	290,539	217,446
Inventories	10,722,092	12,707,550
Prepays	1,237,627	818,732
Total unrestricted current assets	86,935,672	93,152,340
 Current restricted assets:		
Cash and cash equivalents	3,741,927	1,686,638
Investments	145,626,918	120,925,178
Total restricted current assets	149,368,845	122,611,816
Total current assets	236,304,517	215,764,156
 Non-current assets:		
Capital assets, net of accumulated depreciation	641,099,073	644,891,122
Unamortized regulatory assets	2,532,550	3,028,289
Total non-current assets	643,631,623	647,919,411
Total assets	879,936,140	863,683,567
 Deferred Outflows of Resources		
Deferred charge on refunding	20,993,617	17,362,665
Deferred charge - fuel cost under recovery	-	3,110,446
Unrealized contributions and losses related to pension	11,011,401	3,854,651
Total deferred outflows of resources	32,005,018	24,327,762
Total assets plus deferred outflows of resources	\$ 911,941,158	\$ 888,011,329

Continued

PUBLIC UTILITIES BOARD OF THE CITY OF BROWNSVILLE, TEXAS

(A Component Unit of the City of Brownsville, Texas)

Statements of Net Position - Continued

September 30, 2016 and 2015

Liabilities	2016	2015
Current liabilities:		
Accounts payable	\$ 16,229,882	\$ 17,591,319
Accrued vacation and sick leave	6,140,311	6,008,007
Due to primary government	2,748,853	2,772,669
Self insurance worker's compensation claims	90,870	143,657
Total unrestricted current liabilities	<u>25,209,916</u>	<u>26,515,652</u>
Current liabilities payable from restricted assets:		
Accounts payable and accrued liabilities	503,649	358,434
Accrued interest	1,169,743	1,262,928
Customer deposits	3,863,989	3,763,074
Current portion of revenue bonds payable	14,239,000	13,453,000
Commercial paper	7,000,000	-
Total current liabilities payable from restricted assets	<u>26,776,381</u>	<u>18,837,436</u>
Total current liabilities	<u>51,986,297</u>	<u>45,353,088</u>
Non-current liabilities:		
Revenue bonds payable net of unamortized premium	331,348,392	342,796,806
Other post-employment benefits	8,674,722	7,866,350
Net pension liability	33,941,014	13,816,408
Self insurance worker's compensation claims	42,425	69,077
Total non-current liabilities	<u>374,006,553</u>	<u>364,548,641</u>
Total liabilities	<u>425,992,850</u>	<u>409,901,729</u>
Deferred Inflows of Resources		
Deferred credit - fuel cost over recovery	303,078	-
Unrealized contributions and losses related to pension	2,383,320	2,009,154
Total deferred inflows of resources	<u>2,686,398</u>	<u>2,009,154</u>
Total liabilities plus deferred inflows of resources	<u>428,679,248</u>	<u>411,910,883</u>
Net Position		
Net investment in capital assets	310,655,228	308,013,036
Restricted for:		
Debt service	3,576,530	3,513,044
Repair and replacement	110,290,480	86,247,310
Operating reserve	17,000,223	17,000,180
Fuel adjustment subaccount	11,475,000	9,000,000
Capital projects	1,454,010	1,359,583
Unrestricted	28,810,439	50,967,293
Total net position	<u>483,261,910</u>	<u>476,100,446</u>
Total liabilities, deferred inflows of resources, and net position	\$ <u>911,941,158</u>	\$ <u>888,011,329</u>

See accompanying notes to financial statements.

PUBLIC UTILITIES BOARD OF THE CITY OF BROWNSVILLE, TEXAS

(A Component Unit of the City of Brownsville, Texas)

Statements of Revenues, Expenses, and Changes in Net Position

For the Fiscal Years Ended September 30, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Operating revenues:		
Sales and service charges	\$ 207,550,223	\$ 207,767,498
Less utilities service to the City of Brownsville, Texas	<u>(4,804,112)</u>	<u>(4,809,741)</u>
Total operating revenues	<u>202,746,111</u>	<u>202,957,757</u>
Operating expenses:		
Purchased power and fuel	65,976,964	65,220,979
Personnel services	49,076,784	33,302,525
Materials and supplies	6,960,626	7,347,093
Repairs and maintenance	2,666,119	2,983,094
Contractual and other services	24,443,206	21,521,617
Depreciation	<u>29,063,661</u>	<u>29,507,267</u>
Total operating expenses	<u>178,187,360</u>	<u>159,882,575</u>
Operating income	<u>24,558,751</u>	<u>43,075,182</u>
Nonoperating revenues (expenses):		
Investment and interest income	1,202,314	841,219
Interest expense	(14,743,208)	(14,509,231)
Loss on disposition of capital assets	(1,019,326)	(3,577,605)
Other	457,298	1,598,769
Payments to City of Brownsville	<u>(9,822,602)</u>	<u>(9,040,104)</u>
Net nonoperating revenues (expenses)	<u>(23,925,524)</u>	<u>(24,686,952)</u>
Income before capital contributions	633,227	18,388,230
Capital contributions	<u>6,528,237</u>	<u>12,965,169</u>
Change in net position	7,161,464	31,353,399
Net position, beginning of year	476,100,446	457,590,350
Prior period adjustment	<u>-</u>	<u>(12,843,303)</u>
Net position, beginning of year as restated	<u>476,100,446</u>	<u>444,747,047</u>
Net position, end of year	<u>\$ 483,261,910</u>	<u>\$ 476,100,446</u>

See accompanying notes to financial statements.

PUBLIC UTILITIES BOARD OF THE CITY OF BROWNSVILLE, TEXAS

(A Component Unit of the City of Brownsville, Texas)

Statements of Cash Flows

For the Fiscal Years Ended September 30, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Cash flows from operating activities:		
Cash received from customers	\$ 215,766,161	\$ 209,615,249
Cash payments to suppliers for goods and services	(94,997,366)	(115,457,036)
Cash payments to employees for services	<u>(49,153,373)</u>	<u>(32,529,756)</u>
Net cash provided by operating activities	<u>71,615,422</u>	<u>61,628,457</u>
Cash flows from non-capital financing activities:		
Payments to City of Brownsville	<u>(9,846,418)</u>	<u>(8,629,861)</u>
Net cash (used in) non-capital financing activities	<u>(9,846,418)</u>	<u>(8,629,861)</u>
Cash flows from capital and related financing activities:		
Bond proceeds	-	20,000,000
Commercial paper proceeds	7,000,000	7,000,000
Commercial paper payments	-	(20,000,000)
Principal paid on capital debt - bond issues	(13,453,000)	(13,306,000)
Interest paid on capital debt	(14,836,393)	(14,478,950)
Capital contributions	5,885,230	8,813,935
Acquisition and construction of capital assets	<u>(24,628,606)</u>	<u>(30,475,800)</u>
Net cash (used in) capital and related financing activities	<u>(40,032,769)</u>	<u>(42,446,815)</u>
Cash flows from investing activities:		
Interest received	1,129,221	775,269
Purchases of investment securities	(642,385,368)	(503,934,813)
Proceeds from sales of investment securities	<u>618,053,410</u>	<u>491,186,949</u>
Net cash (used in) investing activities	<u>(23,202,737)</u>	<u>(11,972,595)</u>
Net (decrease) in cash and cash equivalents	(1,466,502)	(1,420,814)
Cash and cash equivalents, beginning of year	<u>19,074,768</u>	<u>20,495,582</u>
Cash and cash equivalents, end of year	\$ <u><u>17,608,266</u></u>	\$ <u><u>19,074,768</u></u>

Continued

PUBLIC UTILITIES BOARD OF THE CITY OF BROWNSVILLE, TEXAS

(A Component Unit of the City of Brownsville, Texas)

Statements of Cash Flows - Continued

For the Fiscal Years Ended September 30, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 24,558,751	\$ 43,075,182
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	29,063,661	29,507,267
Non-operating expense	(906,655)	(2,067,848)
Provisions for uncollectible accounts	(321,490)	(171,222)
Changes in operating assets and liabilities:		
(Increase) decrease in accounts receivable	457,969	2,431,665
(Increase) decrease in inventory	1,985,458	(3,062,631)
(Increase) decrease in prepaids	(418,895)	(41,318)
Increase (decrease) in accounts payable and accrued liabilities	20,194,001	(2,002,889)
Increase (decrease) in unearned revenues	138,463	507
Increase (decrease) in accrued vacation and sick leave	132,304	(7,650)
Increase (decrease) in deferred credit – fuel cost recovery	3,413,524	(4,422,294)
Increase (decrease) in customer deposits liability	100,915	235,185
Changes in deferred inflows of resources	374,166	2,009,154
Changes in deferred outflows of resources	(7,156,750)	(3,854,651)
Net cash provided by operating activities	<u>\$ 71,615,422</u>	<u>\$ 61,628,457</u>
Non-cash investing, capital, and financing activities:		
Contribution in aid of construction	\$ 643,007	\$ 4,151,234
Bond proceeds deposited into escrow for refunding long-term debt	46,901,527	84,396,257
Changes in fair value	36,639	-
Reconciliation of cash and cash equivalents per Statements of Cash Flows to the Balance Sheets:		
Cash and cash equivalents:		
Unrestricted	\$ 13,866,339	\$ 17,388,130
Restricted	<u>3,741,927</u>	<u>1,686,638</u>
Total Cash and Cash Equivalents	<u>\$ 17,608,266</u>	<u>\$ 19,074,768</u>

See accompanying notes to the financial statements.

PUBLIC UTILITIES BOARD OF THE CITY OF BROWNSVILLE, TEXAS
(A Component Unit of the City of Brownsville, Texas)

Notes to Financial Statements

September 30, 2016 and 2015

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The following is a summary of significant accounting policies employed in the preparation of these financial statements.

(a) *The Reporting Entity*

The Public Utilities Board of the City of Brownsville, Texas (Public Utilities Board), a component unit of the City of Brownsville, Texas (City), was formed in 1960 to provide electric, water, and wastewater services to its customers in the Brownsville area. The financial statements of the Public Utilities Board have been prepared in conformity with accounting principles generally accepted in the United States of America as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

The Public Utilities Board is a component unit of the City of Brownsville, Texas based upon the selection of the governing authority. It is a separate operating authority established by the City's charter. Its purpose is to own, operate, and maintain a combined utilities system which provides the City and certain adjacent unincorporated areas with electricity, water, and wastewater services. The specific elements of oversight responsibility of the Public Utilities Board is that the City Commission appoints six of the seven-member governing board and the Mayor of the City serves Ex-Officio as the seventh member. Each appointed board member serves a four-year term. The Public Utilities Board does not have the right to encumber, sell, or hypothecate the utilities system. The specific elements of accountability for fiscal matters are (1) the City Commission is vested with the right to set utility rates and approve the issuance of debt and (2) the City has the right to share in the surplus, if any, of the Public Utilities Board. Further, the Public Utilities Board is not required to pay any property taxes or franchise taxes to the City, and the City is not required to pay for the utility services furnished to the City by the Public Utilities Board. The financial statements presented here are also included in the Comprehensive Annual Financial Report of the City of Brownsville, Texas.

The reporting entity of the Public Utilities Board consists of the primary government (in this case, the Public Utilities Board) and a blended component unit, Southmost Regional Water Authority (the Authority). The Authority is a conservation and reclamation district created pursuant to Article XVI, Section 59, of the Texas Constitution and the Act of June 12, 1981, 67th Leg., Ch. 511, 1981 Tex. Gen. Laws 2196. The Authority is reported as a blended component unit because the Public Utilities Board manages the day-to-day operations and owns 92.91% of the Authority entitling it to 92.91% of the total water allocation.

The Authority provides treated water to various areas of Cameron County. Essential disclosures related to the Authority are included in its complete financial statements. These statements may be obtained at P.O. Box 3270, Brownsville, Texas 78523-3270.

(b) *Measurement Focus, Basis of Accounting, and Financial Statement Presentation*

The financial statements are presented in accordance with accounting standards generally accepted in the United States of America for proprietary funds of governmental entities. The Public Utilities Board complies with all applicable pronouncements of the GASB. The Public Utilities Board is accounted for as a proprietary fund. Proprietary funds are used to account for operations that are

PUBLIC UTILITIES BOARD OF THE CITY OF BROWNSVILLE, TEXAS
(A Component Unit of the City of Brownsville, Texas)

Notes to Financial Statements

September 30, 2016 and 2015

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

(b) Measurement Focus, Basis of Accounting, and Financial Statement Presentation – Continued

financed and operated in a manner similar to private business enterprises where the intent is to recover the cost of operations through user charges. A proprietary fund is accounted for on the “economic resources” measurement focus using the accrual basis of accounting, under which revenues are recognized in the accounting period in which they are earned and the related expenses are recorded in the accounting period incurred, if measurable. All assets and liabilities are included on the balance sheet.

(c) Current Year GASB Statement Implementations

In fiscal year 2016, the Public Utilities Board implemented the following GASB statements:

GASB Statement No. 72, *Fair Value Measurement and Application*, became effective for the Public Utilities Board beginning with its fiscal year ending September 30, 2016. This Statement addresses accounting and financial reporting issues related to fair value measurements. The definition of *fair value* is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This Statement provides guidance for determining a fair value measurement for financial reporting purposes. This Statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements.

This Statement requires a government to use valuation techniques that are appropriate under the circumstances and for which sufficient data are available to measure fair value. The techniques should be consistent with one or more of the following approaches: the market approach, the cost approach, or the income approach. Valuation techniques should be applied consistently, though a change may be appropriate in certain circumstances. Valuation techniques maximize the use of relevant observable inputs and minimize the use of unobservable inputs.

This Statement establishes a hierarchy of inputs to valuation techniques used to measure fair value. That hierarchy has three levels. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities. Level 2 inputs are inputs—other than quoted prices—included within Level 1 that are observable for the asset or liability, either directly or indirectly. Finally, Level 3 inputs are unobservable inputs, such as management’s assumption of the default rate among underlying mortgages of a mortgage-backed security.

This Statement also requires disclosures to be made about fair value measurements, the level of fair value hierarchy, and valuation techniques. It also requires additional disclosures regarding investments in certain entities that calculate net asset value per share (or its equivalent).

PUBLIC UTILITIES BOARD OF THE CITY OF BROWNSVILLE, TEXAS
(A Component Unit of the City of Brownsville, Texas)

Notes to Financial Statements

September 30, 2016 and 2015

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

(c) Current Year GASB Statement Implementations - Continued

GASB Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not Within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*, became effective for the Public Utilities Board beginning with its fiscal year ending September 30, 2016. The objective of this Statement is to improve the usefulness of information about pensions included in the general purpose external financial reports of state and local governments for making decisions and assessing accountability. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for all postemployment benefits with regard to providing decision-useful information, supporting assessments of accountability and interperiod equity, and creating additional transparency.

GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, became effective for the Public Utilities Board beginning with its fiscal year ending September 30, 2016. The objective of this Statement is to identify—in the context of the current governmental financial reporting environment—the hierarchy of generally accepted accounting principles (GAAP). The “GAAP hierarchy” consists of the sources of accounting principles used to prepare financial statements of state and local governmental entities in conformity with GAAP and the framework for selecting those principles. This Statement reduces the GAAP hierarchy to two categories of authoritative GAAP and addresses the use of authoritative and nonauthoritative literature in the event that the accounting treatment for a transaction or other event is not specified within a source of authoritative GAAP. This Statement supersedes Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*.

In fiscal year 2015, the Public Utilities Board implemented the following GASB statements:

GASB Statement No. 68, *Accounting and Financial Reporting for Pensions - an amendment of GASB Statement No. 27*, became effective for the Public Utilities Board beginning with its year ending September 30, 2015. This Statement establishes standards for measuring and recognizing liabilities, deferred outflows of resources, and deferred inflows of resources, and expenses related to pension. For defined benefit pensions, this Statement identifies the methods and assumptions that should be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. The impact for the Public Utilities Board is as follows:

Net pension liability – The net pension liability reported under GASB Statement No. 68 is the difference between the actuarial present value of projected pension benefit payments attributable to employees’ past service and the Plan’s fiduciary net position. Previous to this new guidance, a liability was recognized only to the extent that contributions made to the plan were exceeded by the actuarially calculated contributions.

Deferred outflows of resources and deferred inflows of resources – GASB Statement No. 68 requires recognition of deferred outflows and inflows of resources associated with the difference between projected and actual earning on Plan investments, to be amortized to

PUBLIC UTILITIES BOARD OF THE CITY OF BROWNSVILLE, TEXAS
(A Component Unit of the City of Brownsville, Texas)

Notes to Financial Statements

September 30, 2016 and 2015

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

(c) Current Year GASB Statement Implementations - Continued

pension expense over a closed five-year period. Also to be recognized as deferred outflows and inflows of resources are differences between expected and actual experience with regard to economic or demographic factors in the measurement of total pension liability, to be amortized to pension expense over a closed period equal to the average of the expected remaining service lives of all employees receiving pension benefits. Employer contributions to the pension made between the net pension liability measurement date and the employer's fiscal year end are recognized as deferred outflows of resources, to be included in pension expense in the subsequent fiscal year.

GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date*, an amendment of GASB Statement No. 68, became effective for the Public Utilities Board beginning with its year ending September 30, 2015. GASB Statement No. 71, provides guidance for amounts associated with contributions, if any, made by a contributing entity to a defined benefit pension plan after the measurement date of the government's beginning net pension liability. A beginning deferred outflow of resources is required for pension contributions made subsequent to the measurement date of the beginning net pension liability. The effect of this guidance on the Public Utilities Board resulted in the recognition of a deferred outflow of resources for contributions made subsequent to the measurement date of the Public Utilities Board's beginning net pension liability.

(d) Operating Revenues and Expenses

Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the Public Utilities Board's principal ongoing operations. The principal operating revenues of the Public Utilities Board is charges to customers for sales and services. Operating expenses include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Operating revenue consists of cash receipts from quasi-external transactions with the City and other governments, and other cash receipts that do not result from transactions defined as capital and related financing, non-capital financing, or investment activities.

(e) Utility Service Revenue and Electric Purchased Power Expense

Electric, water, and wastewater revenues are recognized as billed on a cycle basis with recognition of unbilled revenues at September 30, 2016 and 2015, based upon the meter reading dates for the unbilled portion of each cycle. Electric rate schedules include power cost adjustment clauses that permit recovery of purchased power costs, not included in base rates, and in the month after such costs are incurred. The Public Utilities Board charges to expense the cost of purchased power in the period of purchase.

PUBLIC UTILITIES BOARD OF THE CITY OF BROWNSVILLE, TEXAS
(A Component Unit of the City of Brownsville, Texas)

Notes to Financial Statements

September 30, 2016 and 2015

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

(f) Capital Assets

Utility plant-in-service is stated at cost which generally includes the cost of contracted services and certain materials and labor. Maintenance and repairs of property and items determined to be less than units of property are charged to operating and maintenance expenses; major plant replacements are capitalized. Assets acquired through contributions, such as those from land developers, are capitalized at estimated fair value at the date contributed. Capital assets are defined by the Public Utilities Board as assets with an initial, individual cost of more than \$5,000 and an estimated useful life in excess of eighteen months.

Meter and line transformer inventory have been included in utility plant to conform to Federal Energy Regulatory Commission guidelines.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets. The following estimated useful lives are used for depreciation purposes in 2016 and 2015:

Classification	Range of lives
Electric plant-in-service	30 to 50 years
Water & Wastewater plant-in-service	30 to 50 years
Buildings	30 to 50 years
Improvements other than buildings	25 to 50 years
Equipment	10 to 50 years
Vehicles	3 to 5 years

(g) Investments

The Public Utilities Board invests funds in accordance with its policy, bond indentures, and the Texas Public Funds Investment Act. Investments consist primarily of United States Treasury obligations and government-backed securities. Statutes authorize the Public Utilities Board to invest in obligations of the United States or its agencies and instrumentalities; direct obligations of the State of Texas or its agencies; obligations of states, agencies, counties, cities and other political subdivisions of any state rated not less than A or its equivalent; certificates of deposit; certain commercial paper; certain mutual funds; and fully collateralized repurchase agreements.

The Public Utilities Board follows the provisions of GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. In accordance with GASB Statement No. 31, the Public Utilities Board's general policy is to report short-term investments at amortized cost. All other investments are reported at fair value. The term "short-term" refers to investments that have a remaining term to maturity of one year or less at time of purchase. Fair value determinations of all securities are made on a quarterly basis.

(h) Inventories

Materials and supplies inventories are stated at cost. Fuel and coal inventories are valued at cost using the last-in first-out method.

PUBLIC UTILITIES BOARD OF THE CITY OF BROWNSVILLE, TEXAS
(A Component Unit of the City of Brownsville, Texas)

Notes to Financial Statements

September 30, 2016 and 2015

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

(i) Compensated Absences

The Public Utilities Board's annual vacation and sick leave policies allow employees to accumulate and vest in annual vacation and sick leave benefits up to specified limits. Upon termination, employees are paid for any unused vacation and sick leave with certain options available. The Public Utilities Board records its obligations for these unused benefits as they are earned by the employees.

(j) Regulatory Basis Assets

The Public Utilities Board elected to establish a regulatory asset for the debt issuance costs in accordance with regulated operations under GASB Statement No. 62. The debt issuance costs would otherwise have been expensed upon implementation of GASB Statement No. 65.

(k) Cash Equivalents

For purpose of the Statements of Cash Flows, the Public Utilities Board considers money market accounts, certificates of deposit, and investments with original maturities of three months or less from the date of acquisition to be cash equivalents.

(l) Budgets and Budgetary Accounting

The Public Utilities Board is not legally required to adopt a budget; therefore, comparative statements of actual expenses to budget expenses are not included within the financial statements.

(m) Deferred Inflows of Resources

GASB Concept Statement No. 4, *Communication Methods in General Purpose External Financial Reports That Contain Basic Financial Statements*, provided definitions for elements in the financial statements. Deferred inflows of resources are the acquisition of net assets applicable to a future reporting period. GASB Statement No. 63 establishes guidance for reporting this element on the statement of net position, and GASB Statement No. 65 establishes accounting and financial reporting standards that reclassify, as deferred inflows of resources, certain items that were previously reported as liabilities. Deferred inflows of resources related to recoverable fuel costs totaled \$0.3 million at September 30, 2016. Pursuant to GASB Statement No. 68 accounting methodologies adopted beginning in fiscal year 2015, recognition of deferred inflows of resources related to pension amounted to \$2.4 million as of September 30, 2016 and \$2.0 million as of September 30, 2015.

(n) Deferred Outflows of Resources

Deferred outflows of resources are the consumption of net assets applicable to a future reporting period, as defined in GASB Concept Statement No. 4. GASB Statement No. 63 establishes guidance for reporting this element on the statement of net position and GASB Statement No. 65 establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources, certain items that were previously reported as assets.

For current and advance refundings of debt, the difference between the reacquisition price and the net carrying amount of the old debt is recorded as unamortized reacquisition costs and reported as deferred outflows of resources. These amounts are amortized as components of interest expense over

PUBLIC UTILITIES BOARD OF THE CITY OF BROWNSVILLE, TEXAS
(A Component Unit of the City of Brownsville, Texas)

Notes to Financial Statements

September 30, 2016 and 2015

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

(n) Deferred Outflows of Resources - Continued

the shorter of the remaining life of the refunding or the refunded debt. At September 30, 2016, and September 30, 2015, reacquisition costs totaled \$21.0 million and \$17.4 million, respectively. Deferred outflows of resources related to recoverable fuel costs totaled \$3.1 million at September 30, 2015. Pursuant to GASB Statement No. 68 accounting methodologies adopted beginning in fiscal year 2015, recognition of deferred outflows of resources related to pension amounted to \$11.0 million as of September 30, 2016 and \$3.9 million as of September 30, 2015.

(o) Contingent Liabilities

The Public Utilities Board provides for contingent liabilities when it is probable a liability has been incurred and the amount of loss can be reasonably estimated.

(p) Recoverable Fuel Costs

Recoverable fuel costs represent fuel costs incurred by the Public Utilities Board which have not yet been billed to customers or which have been billed to customers based on estimated fuel costs and has not been incurred. The Public Utilities Board recovers these costs via the fuel adjustment charge assessed with the monthly utility bills. At September 30, 2016 and 2015, the Public Utilities Board had over collected \$303,078 and under collected \$3,110,446, respectively, in current recoverable fuel costs. These monies are considered either a liability or receivable as the amounts deferred are expected to be offset by October fuel charges.

(q) Grant Revenue

Revenue from state and federal grants is recognized as earned to the extent of incurred program expenses. Grant funds are considered to be earned when all eligibility requirements have been met. Accordingly, when such funds are received in advance, they are recorded as unearned revenue.

(r) Restricted Net Position

Net position is restricted for the following purposes at September 30, 2016 and 2015:

	<u>2016</u>	<u>2015</u>
Debt Service	\$ 3,576,530	\$ 3,513,044
Repair and replacement	110,290,480	86,247,310
Operating reserve	17,000,223	17,000,180
Fuel adjustment subaccount	11,475,000	9,000,000
Capital projects	1,454,010	1,359,583
Total restricted net position	<u>\$ 143,796,243</u>	<u>\$ 117,120,117</u>

The above restricted net position is all subject to restrictions externally imposed by creditors through bond covenants.

PUBLIC UTILITIES BOARD OF THE CITY OF BROWNSVILLE, TEXAS
(A Component Unit of the City of Brownsville, Texas)

Notes to Financial Statements

September 30, 2016 and 2015

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – Continued

(r) Restricted Net Position – Continued

In accordance with bond covenants related to the funds and accounts and flow of funds, the Public Utilities Board is required to retain in the Plant Fund a reserve amount to pay operating and maintenance expenses of not less than two months of budgeted operating and maintenance expenses for the current fiscal year.

(s) Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

(t) Comparative Data/Reclassifications

Comparative total data for the prior year have been presented in the accompanying financial statements in order to provide an understanding of changes in the Public Utilities Board's financial position and operations. Also, certain amounts presented in the prior year data have been reclassified in order to be consistent with the current year's presentation.

(u) Deferred Compensation Plan

The Public Utilities Board offers a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all Public Utilities Board employees, permits them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency.

Amendments to the laws governing Section 457 deferred compensation plans substantially became effective January 1, 1997. The Public Utilities Board approved plan amendments such that plan assets are held in trust, with Nationwide Retirement Solutions, Inc. as trustee, for the exclusive benefit of the plan participants and their beneficiaries. The assets cannot be diverted to any other purpose. The Public Utilities Board does not have legal access to the resources of the deferred compensation plan; as such the plan is not reported in the Public Utilities Board's financial statements.

(v) Pensions

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the Fiduciary Net Position of the Texas Municipal Retirement System (TMRS) and additions to/deductions from TMRS's Fiduciary Net Position have been determined on the same basis as they are reported by TMRS. For this purpose, plan contributions are recognized in the period that compensation is reported for the employee, which is when contributions are legally due. Benefit payments and refunds are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

PUBLIC UTILITIES BOARD OF THE CITY OF BROWNSVILLE, TEXAS
(A Component Unit of the City of Brownsville, Texas)

Notes to Financial Statements

September 30, 2016 and 2015

(2) DEPOSITS AND INVESTMENTS

(a) *Basis of Investments*

On November 9, 2015, the Public Utilities Board approved a revised Investment Policy which included an "Investment Strategy Statement" that addressed the understanding of investment suitability, the preservation and safety of principal, liquidity, marketability of the investment prior to maturity, diversification, and yield of the investment portfolio. In regards to the safety and risk of investments, the Public Utilities Board abided by the Investment Policy that requires all available funds to be invested in conformance with state and federal regulations, applicable bond ordinance requirements, and GASB's standards. Each investment transaction shall seek to first and foremost ensure that capital losses are avoided, whether they are from securities' defaults or erosion of fair value.

The Public Utilities Board's bank deposits and Certificates of Deposit investments were entirely covered by the Federal Deposit Insurance Corporation or by collateral held by a third-party safekeeping bank in the Public Utilities Board's name.

The carrying value of deposits with financial institutions approximates fair value. As of September 30, 2016 and 2015, the Public Utilities Board had the following investments:

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PUBLIC UTILITIES BOARD OF THE CITY OF BROWNSVILLE, TEXAS
(A Component Unit of the City of Brownsville, Texas)

Notes to Financial Statements

September 30, 2016 and 2015

(2) DEPOSITS AND INVESTMENTS - Continued

(a) Basis of Investments – Continued

Investment Type	September 30, 2016			
	Amount	Weighted Avg Maturity (Days)	Allocation	Rating
Money Market Mutual Funds	\$ 10,255,120	1	5.7%	AAAm
Certificates of Deposit	17,629,346	21	9.9%	A1P1
U.S. Agencies	24,397,360	50	13.7%	AA+
U.S Treasury Note	554,629	1	0.3%	AAA
Local Government Investment Pools	125,692,976	1	70.4%	AAAm
Total	<u>\$ 178,529,431</u>		<u>100.0%</u>	

Investment Type	September 30, 2015			
	Amount	Weighted Avg Maturity (Days)	Allocation	Rating
Money Market Mutual Funds	\$ 16,466,536	1	10.5%	AAAm
Certificates of Deposit	22,529,625	48	14.8%	A1P1
U.S. Agencies	40,551,477	217	25.9%	AA
U.S Treasury Note	554,629	3	0.4%	AAAm
Local Government Investment Pools	74,095,206	1	48.4%	AAAm
Total	<u>\$ 154,197,473</u>		<u>100.0%</u>	

Interest rate risk – In accordance with the Public Utilities Board’s Investment Policy the weighted average to maturity for the Public Utilities Board’s portfolio limits the maximum allowable maturity to two years by not exceeding the anticipated cash flow requirements. As of September 30, 2016 and 2015, the investment portfolio had maturities that met anticipated cash flow requirements.

The Public Utilities Board’s invests in TexPool, TexasDAILY, and TexStar to provide its liquidity needs. These pools are structured somewhat like money market mutual funds and allow shareholders the ability to deposit or withdraw funds on a daily basis. These pools are rated AAAM and must maintain a dollar weighted average maturity not to exceed a 60-day limit. At September 30, 2016, TexPool, TexasDAILY, and TexStar had a weighted average maturity of 45 days, 55 days, and 41 days respectively. The Public Utilities Board considers the holdings in these funds to have a weighted

PUBLIC UTILITIES BOARD OF THE CITY OF BROWNSVILLE, TEXAS
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Notes to Financial Statements

September 30, 2016 and 2015

(2) DEPOSITS AND INVESTMENTS - Continued

(a) Basis of Investments - Continued

average maturity of one day, due to the fact that the share position can usually be redeemed each day at the discretion of the shareholder, unless there has been a significant change in value.

Credit risk – The Public Utilities Board identifies and manages credit risks by following the Investment Policy. The Public Utilities Board implements its investment strategy, establishes and monitors compliance with investment policies and procedures, and consistently monitors prudent risk controls. The Public Utilities Board will seek to control the risk of loss by monitoring the ratings of portfolio positions to assure compliance with the rating requirements imposed by the Public Funds Investment Act. The Public Utilities Board also manages exposure to credit risk by limiting its investments to a rating of “A” or better. As of September 30, 2016 and 2015, the Public Utilities Board’s security agencies investments with a rating of AA or above.

Custodial credit risk – In accordance with the Public Utilities Board’s Investment Policy, the financial institution must collateralize all funds with a minimum of 102% of the fair value of the principal portion. The Public Utilities Board seeks to control the risk of loss due to the failure of a security issuer or grantor. Such risk shall be controlled by investing only in the safest types of securities as defined in the Investment Policy.

The Public Utilities Board signed an agreement with its financial institution pledging funds to 102% minimum of the fair value of the principal portion. As of September 30, 2016, the Public Utilities Board invested 13.7% in U.S. Agencies (Federal Home Loan Bank, Federal National Mortgage Association, Federal Home Loan Mortgage Corporation), which hold high ratings by nationally recognized statistical rating organizations. Investments in U.S. Agencies are proven to be the safest investments with minimal risk of loss. All investments are insured, registered, or held by an agent in the Public Utilities Board’s name; therefore, the Public Utilities Board is not exposed to custodial credit risk.

Concentration of credit risk – In accordance with the Investment Policy, the Public Utilities Board manages its credit risk exposure through diversification, and limiting its investments in each government-sponsored security to 75%. As of September 30, 2016 and 2015, the portfolio was in compliance as noted above.

TexPool – The State of Texas Comptroller of Public Accounts exercises oversight responsibility over TexPool, the Texas Local Government Investment Pool, along with Federated Investors managing the daily operations of the pool under a contract with the State Comptroller. Oversight includes the ability to significantly influence operations, designation of management and accountability for fiscal matters. Additionally, the State Comptroller has established an advisory board composed both of participants in TexPool and of other persons who do not have a business relationship with TexPool. The advisory board members review the investment policy and management fee structure. Finally, TexPool is rated AAAM by Standard & Poor’s.

As a requirement to maintain the rating weekly portfolio, information must be submitted to Standard & Poor’s as well as the office of the Comptroller of Public Accounts for review. TexPool operates in a manner consistent with the SEC’s Rule 2a-7 of the Investment Company Act of 1940. As such,

PUBLIC UTILITIES BOARD OF THE CITY OF BROWNSVILLE, TEXAS
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Notes to Financial Statements

September 30, 2016 and 2015

(2) DEPOSITS AND INVESTMENTS - Continued

(a) Basis of Investments – Continued

TexPool uses amortized cost to report net assets and share prices since that amount approximates fair value.

TexSTAR – Texas Short Term Asset Reserve Program (TexSTAR) is a local government investment pool providing short-term liquidity requirements. JPMorgan Fleming Asset Management, Inc. and First Southwest Asset Management, Inc. serve as co-administrators under an agreement with the TexSTAR Board of Directors to provide investment and participant services for this pool. JPMorgan Chase Bank or its subsidiary J.P. Morgan Investor Services Company provides the custodial, transfer agency, fund accounting, and depository services for this pool. At year end, TexSTAR was rated AAAM by Standard & Poor's. The Public Utilities Board reports its investment in TexSTAR at the fair value amount provided by TexSTAR, which is the same as the value of the pool share.

TexasTERM/TexasDaily – TexasTERM/TexasDaily is a local government investment pool. Administrative and investment services to the pool are provided by PFM Asset Management LLC, under an agreement with the TexasTERM Advisory Board and act on behalf of the pool participants. At year end, TexasTERM was rated AAAM by Standard & Poor's. The Public Utilities Board reports its investment in TexasTERM at the fair value amount provided by TexasTERM, which is the same as the value of the pool share.

Fair Value measurement – The Public Utilities Board records assets and liabilities in accordance with GASB Statement No. 72, *Fair Value Measurement and Application*, which determines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurement. The Public Utilities Board's fair value measurements are performed on a recurring basis.

As a basis for considering market participant assumptions in fair value measurements, Statement No. 72 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three levels:

- Level 1 – inputs are quoted prices (unadjusted) for identical assets or liabilities in active markets that a government can access at the measurement date. Equity securities and U.S. Government Treasury securities are examples of Level 1 inputs.
- Level 2 – inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. Government agency and mortgage-backed securities and certificates of deposit are examples of Level 2 inputs.
- Level 3 – inputs are unobservable inputs that reflect the Authority's own assumptions about factors that market participants would use in pricing the asset or liability (including assumptions about risk).

The valuation technique the Public Utilities Board uses to measure fair value is the market approach. This approach uses prices and other relevant information generated by market transactions involving identical or comparable assets, liabilities, or a group of assets and liabilities, and is applied consistently.

PUBLIC UTILITIES BOARD OF THE CITY OF BROWNSVILLE, TEXAS
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(2) DEPOSITS AND INVESTMENTS - Continued

(a) Basis of Investments – Continued

The following table presents fair value balances and their levels within the fair value hierarchy as of September 30, 2016. Investment balances presented exclude amounts related to money market mutual fund investments and 2a7-like external investment pools accounted for using amortized cost.

	September 30, 2016			
	Level 1	Level 2	Level 3	Total
Fair Value Investments				
U.S. Agencies				
Federal Home Loan Mtg Corp	\$ -	\$ 18,398,614	\$ -	18,398,614
Federal Home Loan Bank	-	5,998,746	-	5,998,746
U.S. Treasury Note	554,629	-	-	554,629
Certificates of Deposit	-	17,629,346	-	17,629,346
Total fair value investments	<u>\$ 554,629</u>	<u>\$ 42,026,706</u>	<u>\$ -</u>	<u>\$ 42,581,335</u>

	September 30, 2015			
	Level 1	Level 2	Level 3	Total
Fair Value Investments				
U.S. Agencies				
Federal Home Loan Mtg Corp	\$ -	\$ 29,561,617	\$ -	\$ 29,561,617
Federal Farm Credit Bank	-	4,995,860	-	4,995,860
Farmer Mac	-	5,994,000	-	5,994,000
U.S. Treasury Note	554,629	-	-	554,629
Certificates of Deposit	-	22,529,625	-	22,529,625
Total fair value investments	<u>\$ 554,629</u>	<u>\$ 63,081,102</u>	<u>\$ -</u>	<u>\$ 63,635,731</u>

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PUBLIC UTILITIES BOARD OF THE CITY OF BROWNSVILLE, TEXAS
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September 30, 2016 and 2015

(3) CAPITAL ASSETS

Changes in the Public Utilities Board's capital assets for the year ended September 30, 2016 were as follows:

	Beginning Balance 2015	Additions	Deletions	Reclassifications	Ending Balance 2016
Capital assets, not being depreciated:					
Land	\$ 26,054,237	\$ -	\$ -	\$ 1,572,223	\$ 27,626,460
Construction in progress	91,255,816	23,525,605	-	(26,096,639)	88,684,782
Total capital assets, not being depreciated	<u>117,310,053</u>	<u>23,525,605</u>	<u>-</u>	<u>(24,524,416)</u>	<u>116,311,242</u>
Capital assets, being depreciated:					
Plant	737,951,381	2,832,785	(2,903,038)	8,383,538	746,264,666
Buildings and structures	89,380,603	18,026	(330,200)	2,792,377	91,860,806
Improvements other than buildings	45,915,462	-	(21,857)	2,741,423	48,635,028
Equipment	125,570,210	2,098,088	(4,742,549)	10,607,078	133,532,827
Total capital assets, being depreciated	<u>998,817,656</u>	<u>4,948,899</u>	<u>(7,997,644)</u>	<u>24,524,416</u>	<u>1,020,293,327</u>
Less accumulated depreciation for:					
Plant	(330,898,244)	(20,915,815)	617,584	(14,821,921)	(366,018,396)
Buildings and structures	(36,492,001)	(2,191,594)	274,589	55,123	(38,353,883)
Improvements other than buildings	(38,137,684)	(1,214,203)	19,918	14,793,477	(24,538,492)
Equipment	(65,708,658)	(4,742,049)	3,882,661	(26,679)	(66,594,725)
Total accumulated depreciation	<u>(471,236,587)</u>	<u>(29,063,661)</u>	<u>4,794,752</u>	<u>-</u>	<u>(495,505,496)</u>
Capital assets, net	<u>\$ 644,891,122</u>	<u>\$ (589,157)</u>	<u>\$ (3,202,892)</u>	<u>\$ -</u>	<u>\$ 641,099,073</u>

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September 30, 2016 and 2015

(3) CAPITAL ASSETS - Continued

Changes in the Public Utilities Board's capital assets for the year ended September 30, 2015 were as follows:

	Beginning Balance 2014	Additions	Deletions	Reclassifications	Ending Balance 2015
Capital assets, not being depreciated:					
Land	\$ 25,201,514	\$ 630,000	\$ -	\$ 222,723	\$ 26,054,237
Construction in progress	111,966,150	34,513,311	-	(55,223,645)	91,255,816
Total capital assets, not being depreciated	<u>137,167,664</u>	<u>35,143,311</u>	<u>-</u>	<u>(55,000,922)</u>	<u>117,310,053</u>
Capital assets, being depreciated:					
Plant	715,152,420	5,079,966	(15,760,900)	33,479,895	737,951,381
Buildings and structures	75,225,315	115,027	(925,794)	14,966,055	89,380,603
Improvements other than buildings	45,910,053	-	(660)	6,069	45,915,462
Equipment	119,301,189	1,488,620	(1,768,502)	6,548,903	125,570,210
Total capital assets, being depreciated	<u>955,588,977</u>	<u>6,683,613</u>	<u>(18,455,856)</u>	<u>55,000,922</u>	<u>998,817,656</u>
Less accumulated depreciation for:					
Plant	(320,184,071)	(20,153,437)	9,255,214	184,050	(330,898,244)
Buildings and structures	(34,896,839)	(2,125,962)	678,246	(147,446)	(36,492,001)
Improvements other than buildings	(36,090,203)	(2,027,033)	-	(20,448)	(38,137,684)
Equipment	(61,814,174)	(5,200,835)	1,322,507	(16,156)	(65,708,658)
Total accumulated depreciation	<u>(452,985,287)</u>	<u>(29,507,267)</u>	<u>11,255,967</u>	<u>-</u>	<u>(471,236,587)</u>
Capital assets, net	<u>\$ 639,771,354</u>	<u>\$ 12,319,657</u>	<u>\$ (7,199,889)</u>	<u>\$ -</u>	<u>\$ 644,891,122</u>

(4) JOINT OPERATIONS

(a) Oklaunion Project

In May 1986, the Public Utilities Board and Central Power & Light (CP&L), now known as AEP Texas Central Company (TCC), executed the Oklaunion Unit No. 1 Ownership Interest Assignment Agreement (Agreement). This Agreement allowed the Public Utilities Board to purchase an undivided 56.54% of TCC's undivided 17.97% ownership interest in the Oklaunion unit (10.16% of the project as a whole). This Agreement committed the Public Utilities Board to become a 10.16% participant in the Oklaunion unit and obligated the Public Utilities Board to contribute its 10.16% share of the Oklaunion unit's operating expenses. As a result of their participation, the Public Utilities Board is entitled to receive 10.16% of the total power generated by the plant.

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September 30, 2016 and 2015

(4) JOINT OPERATIONS - Continued

(a) Oklaunion Project - Continued

On February 5, 2004, TCC notified the Public Utilities Board that it had auctioned off and sold its ownership interest in Oklaunion Unit No. 1 to Golden Spread Electric Cooperative, Inc. for \$42,750,000, subject to the exercise by the Public Utilities Board refusal to purchase TCC's ownership interest under the Oklaunion Unit No. 1 Construction, Ownership and Operating Agreement dated May 26, 1985. Both the Public Utilities Board and OMPA exercised their rights of first refusal for the entire TCC interest in May 2004 and each deposited in escrow \$42,750,000, respectively. The Public Utilities Board funded its obligation through the sale of Commercial Paper Notes. In May 2006, the Dallas Court of Appeals issued an opinion upholding City of Brownsville's right to acquire an additional interest in Oklaunion Unit No 1.

Golden Spread Electric Cooperative had challenged the City of Brownsville's right to acquire the interest being sold by American Electric Power – Texas Central Company. Golden Spread Electric asked the Texas Supreme Court to overturn the Dallas Court of Appeals' ruling and allow it to buy Texas Central Company's interest instead of the City of Brownsville.

On December 15, 2006, the Texas Supreme Court declined to review a ruling by the Dallas Court of Appeals in favor of the City of Brownsville and the Public Utilities Board. Subsequently on February 14, 2007, the Public Utilities Board completed its purchase of the additional 54 megawatts (7.8%) of the Oklaunion Power System for \$51 million.

(b) Calpine/Hidalgo Project

On December 15, 1999, the Public Utilities Board purchased an undivided interest from Calpine Energy which entitles the Public Utilities Board to 105 MW of the 500 MW combined cycle plant located in Edinburg, Texas, approximately 56 miles from Brownsville, Texas. The unit consists of two gas turbines, a heat recovery steam generator and steam turbine.

(5) SHORT-TERM DEBT

(a) Commercial Paper

Commercial paper balances and activity as of and for the year ended September 30, 2016 are as follows:

	Beginning Balance 2015	Additions	Deletions	Ending Balance 2016
Commercial paper	\$ -	\$ 7,000,000	\$ -	\$ 7,000,000

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(5) SHORT-TERM DEBT - Continued

(a) Commercial Paper - Continued

Commercial paper balances and activity as of and for the year ended September 30, 2015 are as follows:

	Beginning Balance 2014	Additions	Deletions	Ending Balance 2015
Commercial paper	\$ <u>13,000,000</u>	\$ <u>7,000,000</u>	\$ <u>(20,000,000)</u>	\$ <u>-</u>

The Public Utilities Board issued \$7,000,000 of Commercial Paper during 2016 and \$7,000,000 of Commercial Paper during 2015.

On September 25, 2012, the Public Utilities Board issued \$20,690,000 in Utility System Revenue Refunding Bonds, Series 2012. The refunding bonds had a closing date of October 18, 2012 and the proceeds plus \$5,275,000 in issuer contributions were used to defease \$24,450,000 of Commercial Paper Notes.

On April 20, 2004, the City Commission of the City of Brownsville, Texas approved and authorized the issuance of short term obligations in an aggregate principal amount not to exceed \$50,000,000. A total of \$44,500,000 was issued in fiscal year 2004. The purpose of the Commercial Paper Program is to pay for additions, improvements, and extensions to the City's combined electric system, waterworks system and sewer system. The Commercial Paper was used to purchase an additional ownership interest in Oklaunion, an electric generating plant. The Reimbursement and Credit Agreement was executed between the City, acting through the Public Utilities Board, and State Street Bank and Trust Company, Credit and Liquidity Provider, for the Commercial Paper. In order to assure timely payment of the principal of and interest on the Commercial Paper Notes, a Letter of Credit was executed by the City and Deutsche Bank Trust, as beneficiary Issuing and Paying Agency. The stated amount of the Letter of Credit is \$50,000,000 (principal plus accrued interest cannot exceed \$50,000,000).

On September 17, 2013, the City Commission of the City of Brownsville adopted an Ordinance No. 2013-1582 authorizing the issuance of the City of Brownsville, Texas Utilities System Commercial Paper Notes, Series A in a maximum aggregate principal amount of \$100,000,000 outstanding at any time. Subsequently on September 20, 2016, the City Commission of the City of Brownsville adopted Ordinance No. 2016-1619 supplementing the Original Ordinance and authorizing the substitution of the Credit Facility. On November 1, 2016, the City of Brownsville and the Mitsubishi UFJ Financial Group (MUFG) entered into a Reimbursement Agreement related to the Commercial Paper Notes, Series A. The City of Brownsville requested that the Bank issue its Letter of Credit to secure certain payments to be made with respect to the Commercial Paper Notes in the amount of \$111,095,891, of which \$100,000,000 will be available to pay principal of the Commercial Paper Notes upon maturity thereof, and of which \$11,095,891 will be available to pay accrued interest on the Commercial paper Notes at maturity.

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(6) LONG-TERM DEBT

(a) Revenue Bonds

The Public Utilities Board had interest rate swaps in place to fix rates on the variable rate demand bonds (VRDB). With respect to the \$100,000,000 utilities system subordinate lien revenue and refunding bonds, Series 2001, a rate swap was in place to fix the rate at 2.712%. This swap expired in February 2004 and the Public Utilities Board elected to change “modes” for these VRDB’s to “Flex Mode.” This allowed the Public Utilities Board to select a future date to rollover the bonds. These bonds were defeased through a current refunding effective August 2005.

The \$76,400,000 Utilities System Subordinate Lien Revenue and Refunding Variable Rate Bonds, Series 2002, had an outstanding balance of \$52,710,000. The City Commission of the City of Brownsville, Texas authorized the execution of a Rate Cap Agreement effective September 1, 2006 thru September 1, 2011 to serve as insurance against increasing short term rates. The Public Utilities Board executed an agreement with an eligible provider for a notional amount of \$41,880,000 with an interest rate cap of 4.50%. The notional amount of the original swap decreased to \$10,830,000 effective September 1, 2006 and continued to provide a synthetic fixed rate of 2.576%. These bonds were defeased through a current refunding effective May 2008.

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PUBLIC UTILITIES BOARD OF THE CITY OF BROWNSVILLE, TEXAS
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Notes to Financial Statements

September 30, 2016 and 2015

(6) LONG-TERM DEBT – Continued

(a) Revenue Bonds – Continued

Revenue bond balances and activity as of and for the year ended September 30, 2016 are as follows:

	<u>Beginning Balance 2015</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance 2016</u>	<u>Amounts due within one year</u>
Public Utilities Board:					
\$163,725,000 utilities system revenue improvement and refunding bonds, Series 2005A; due in annual installments ranging from \$880,000 to \$16,600,000 through 2031 with interest rates ranging from 3.5% to 5.0%	\$ 100,000	\$ -	\$ -	\$ 100,000	\$ -
\$601,000 utilities system junior lien revenue bonds series 2007; due in annual installments ranging from \$29,000 to \$46,000 through 2026 with interest rates ranging from 3.24% to 5.74%	397,000	-	(28,000)	369,000	29,000
\$77,805,000 utilities system revenue refunding bonds, series 2008; due in annual installments ranging from \$1,220,000 to \$5,065,000 through 2033 with interest rates ranging from 4.0% to 5.0%	61,530,000	-	(45,465,000)	16,065,000	3,110,000
\$20,690,000 utilities system revenue refunding bonds, series 2012; due in annual installments ranging from \$565,000 to \$1,210,000 through 2037 with interest rates ranging from 1.5% to 4.0%	18,970,000	-	(590,000)	18,380,000	605,000
\$840,000 utilities system revenue refunding bonds, series 2012; due in annual installments ranging from \$30,000 to \$60,000 through 2032 with interest rates ranging from .27% to 3.49%	750,000	-	(30,000)	720,000	35,000
\$118,185,000 utilities system revenue refunding bonds, series 2013A; due in annual installments ranging from \$430,000 to \$11,820,000 through 2031 with interest rates ranging from 2.0% to 5.0%	117,315,000	-	(975,000)	116,340,000	950,000
\$94,770,000 utilities system revenue refunding bonds, series 2015; due in annual installments ranging from \$2,950,000 to \$8,995,000 through 2045 with interest rates ranging from 4.0% to 5.0%	94,770,000	-	(7,590,000)	87,180,000	8,185,000
\$39,410,000 utilities system revenue refunding bonds, series 2016; due in annual installments ranging from \$1,720,000 to \$4,125,000 through 2033 with interest rates at 5.00%	-	39,410,000	-	39,410,000	-
Total Public Utilities Board	293,832,000	39,410,000	(54,678,000)	278,564,000	12,914,000

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September 30, 2016 and 2015

(6) LONG-TERM DEBT – Continued

(a) Revenue Bonds – Continued

Revenue bond balances and activity as of and for the year ended September 30, 2016 – continued

	Beginning Balance 2015	Additions	Reductions	Ending Balance 2016	Amounts due within one year
Southmost Regional Water Authority:					
\$9,950,000 water supply contract revenue refunding bonds, series 2006; due in remaining annual installments ranging from \$10,000 to \$1,845,000 through 2032 with interest rate ranging from 3.7% to 5.50%	9,790,000	-	(25,000)	9,765,000	25,000
\$9,295,000 Revenue Bonds, Series 2009A; due in remaining annual installments ranging from \$305,000 to \$310,000 through 2039 with interest rate at 0.0%	7,435,000	-	(310,000)	7,125,000	310,000
\$3,795,000 Revenue Bonds, Series 2009B; due in remaining annual installments ranging from \$125,000 to \$270,000 through 2029 with interest rate ranging from 0.10% to 4.25%	2,950,000	-	(160,000)	2,790,000	165,000
\$13,530,000 water supply contract revenue refunding bonds, series 2012 due in remaining annual installments ranging from \$700,000 to \$1,285,000 through 2027 with interest rate ranging from 3.0% to 5.0%	11,345,000	-	(785,000)	10,560,000	825,000
Total Public Utilities Board and Southmost Regional Water Authority					
	325,352,000	39,410,000	(55,958,000)	308,804,000	14,239,000
Plus:					
Unamortized Premium	32,891,962	7,705,681	(1,917,262)	38,680,381	-
Less:					
Unamortized original issuance discount	(1,994,155)	(250,392)	347,558	(1,896,989)	-
Total long-term debt	<u>\$ 356,249,807</u>	<u>\$ 46,865,289</u>	<u>\$ (57,527,704)</u>	<u>\$ 345,587,392</u>	<u>\$ 14,239,000</u>

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PUBLIC UTILITIES BOARD OF THE CITY OF BROWNSVILLE, TEXAS
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Notes to Financial Statements

September 30, 2016 and 2015

(6) LONG-TERM DEBT – Continued

(a) Revenue Bonds – Continued

Revenue bond balances and activity as of and for the year ended September 30, 2015, are as follows:

	Beginning Balance 2014	Additions	Reductions	Ending Balance 2015	Amounts due within one year
Public Utilities Board:					
\$163,725,000 utilities system revenue improvement and refunding bonds, Series 2005A; due in annual installments ranging from \$880,000 to \$16,600,000 through 2031 with interest rates ranging from 3.5% to 5.0%	\$49,955,000	\$ -	\$(49,855,000)	\$ 100,000	\$ -
\$56,855,000 utilities system revenue improvement refunding bonds, Series 2005B; due in annual installments ranging from \$3,515,000 to \$8,190,000 through 2019 with interest rates ranging from 4.646% to 5.304%	33,725,000	-	(33,725,000)	-	-
\$601,000 utilities system junior lien revenue bonds series 2007; due in annual installments ranging from \$29,000 to \$46,000 through 2026 with interest rates ranging from 3.24% to 5.74%	423,000	-	(26,000)	397,000	28,000
\$77,805,000 utilities system revenue refunding bonds, series 2008; due in annual installments ranging from \$1,220,000 to \$5,065,000 through 2033 with interest rates ranging from 4.0% to 5.0%	64,350,000	-	(2,820,000)	61,530,000	2,960,000
\$12,305,000 utilities system revenue refunding bonds, series 2011; due in annual installments ranging from \$745,000 to \$1,255,000 through 2019 with interest rates ranging from 2.0% to 4.0%	6,950,000	-	(6,950,000)	-	-
\$20,690,000 utilities system revenue refunding bonds, series 2012; due in annual installments ranging from \$565,000 to \$1,210,000 through 2037 with interest rates ranging from 1.5% to 4.0%	19,545,000	-	(575,000)	18,970,000	590,000
\$840,000 utilities system revenue refunding bonds, series 2012; due in annual installments ranging from \$30,000 to \$60,000 through 2032 with interest rates ranging from .27% to 3.49%	780,000	-	(30,000)	750,000	30,000
\$118,185,000 utilities system revenue refunding bonds, series 2013A; due in annual installments ranging from \$430,000 to \$11,820,000 through 2031 with interest rates ranging from 2.0% to 5.0%	117,755,000	-	(440,000)	117,315,000	975,000
\$94,770,000 utilities system revenue refunding bonds, series 2015; due in annual installments ranging from \$2,950,000 to \$8,995,000 through 2045 with interest rates ranging from 4.0% to 5.0%	-	94,770,000	-	94,770,000	7,590,000
Total Public Utilities Board	293,483,000	94,770,000	(94,421,000)	293,832,000	12,173,000

PUBLIC UTILITIES BOARD OF THE CITY OF BROWNSVILLE, TEXAS
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(6) LONG-TERM DEBT – Continued

(a) Revenue Bonds – Continued

Revenue bond balances and activity as of and for the year ended September 30, 2015 – continued

	Beginning Balance 2014	Additions	Reductions	Ending Balance 2015	Amounts due within one year
Southmost Regional Water Authority:					
\$9,950,000 water supply contract revenue refunding bonds, series 2006; due in remaining annual installments ranging from \$10,000 to \$1,845,000 through 2032 with interest rate ranging from 3.7% to 5.50%	9,810,000	-	(20,000)	9,790,000	25,000
\$9,295,000 Revenue Bonds, Series 2009A; due in remaining annual installments ranging from \$305,000 to \$310,000 through 2039 with interest rate at 0.0%	7,745,000	-	(310,000)	7,435,000	310,000
\$3,795,000 Revenue Bonds, Series 2009B; due in remaining annual installments ranging from \$125,000 to \$270,000 through 2029 with interest rate ranging from 0.10% to 4.25%	3,105,000	-	(155,000)	2,950,000	160,000
\$13,530,000 water supply contract revenue refunding bonds, series 2012 due in remaining annual installments ranging from \$700,000 to \$1,285,000 through 2027 with interest rate ranging from 3.0% to 5.0%	12,100,000	-	(755,000)	11,345,000	785,000
Total Public Utilities Board and Southmost Regional Water Authority	326,243,000	94,770,000	(95,661,000)	325,352,000	13,453,000
Plus:					
Unamortized Premium	25,469,016	8,945,752	(1,522,807)	32,891,961	-
Less:					
Unamortized original issuance discount	(1,883,014)	(580,656)	469,515	(1,994,155)	-
Total long-term debt	\$ 349,829,002	\$ 103,135,096	\$ (96,714,292)	\$ 356,249,806	\$ 13,453,000

Principal and interest amounts due for each of the next five years and thereafter to maturity are:

Year Ending September 30:	Principal	Interest	Total
2017	\$ 14,239,000	\$ 13,822,092	\$ 28,061,092
2018	14,806,000	13,196,007	28,002,007
2019	15,337,000	12,491,988	27,828,988
2020	16,059,000	11,756,422	27,815,422
2021	16,746,000	10,999,790	27,745,790
2022-2026	95,287,000	42,543,479	137,830,479
2027-2031	108,275,000	19,603,658	127,878,658
2032-2036	17,155,000	3,489,259	20,644,259
2037-2041	6,600,000	1,530,831	8,130,831
2042-2046	4,300,000	466,438	4,766,438
	<u>\$ 308,804,000</u>	<u>\$ 129,899,964</u>	<u>\$ 438,703,964</u>

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Notes to Financial Statements

September 30, 2016 and 2015

(6) LONG-TERM DEBT – Continued

(a) Revenue Bonds – Continued

The Public Utilities Board is required by various debt agreements to comply with various financial statements and other covenants including maintaining required debt service coverage ratios. No non-compliance with covenants was noted which constitutes an “event of default” under these agreements.

On December 7, 2009, the Authority issued \$9,295,000 in Water Supply Contract Revenue Bonds, Series 2009A and \$3,795,000 in Water Supply Contract Revenue Bonds, Series 2009B through the TWDB Drinking Water State Revolving Fund for the construction of a full scale Micro Filtration Pretreatment System. The Series 2009A bonds were issued at 0.0% interest with annual installments ranging from \$305,000 to \$310,000 through maturity in 2039. The Series 2009B bonds bear interest at a range from 0.10% to 4.25% with annual installments ranging from \$125,000 to \$270,000 through maturity in 2029. Funds are held by the TWDB in an escrow account with Wells Fargo Bank and released through installments as project expenses are incurred.

On February 28, 2011, the Public Utilities Board issued \$12,305,000 in Utilities System Revenue Refunding Bonds, Series 2011. The refunding bonds provided proceeds to refund \$6,270,000 of Junior Lien Exchange Revenue Refunding Bonds, Series 2005A and \$5,980,000 of Junior Lien Exchange Revenue Refunding Bonds, Series 2005B.

On October 1, 2012, the Public Utilities Board issued \$840,000 in Utility System Junior Lien Revenue Bonds, Series 2012. Proceeds from the sale of the Obligations were used for the purpose of funding construction improvements to the wastewater system on the FM 511 – 802 Colonia Project.

On September 25, 2012, the Public Utilities Board issued \$20,690,000 in Utility System Revenue Refunding Bonds, Series 2012. The refunding bonds had a closing date of October 18, 2012 and the proceeds plus \$5,275,000 in issuer contributions were used to defease \$24,450,000 of Commercial Paper notes.

On September 26, 2012, the Authority issued \$13,530,000 in Water Supply Contract Revenue Refunding Bonds, Series 2012. The refunding bonds had a closing date of October 18, 2012 and the proceeds plus the bond premium were used to defease \$14,990,000 of the Series 2002 Revenue Bonds for the years 2013 through 2027.

On May 1, 2013, the Public Utilities Board issued \$118,185,000 in Utilities System Revenue Refunding Bonds, Series 2013. The refunding bond proceeds plus a bond premium of \$16,723,650 were used to defease \$109,985,000 of the Series 2005A Utilities System Revenue Improvement and Refunding Bonds which are callable on September 1, 2015 and funded \$11,818,500 of Public Utilities Board Senior Lien Reserve Fund.

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(6) LONG-TERM DEBT – Continued

(a) Revenue Bonds – Continued

The Public Utilities Board issued \$20,690,000 in aggregate principal amount of Utilities System Revenue Refunding Bonds, Series 2012. The proceeds of the refunding bonds plus \$5,275,000 in issuer contributions were used for a current refunding of \$24,450,000 of Commercial Paper Notes. As a result, the refunded commercial paper notes are considered to be defeased and the liability was been removed from long-term debt.

On July 15, 2015, the Public Utilities Board issued \$94,770,000 in Utilities System Revenue Refunding Bonds, Series 2015. The refunding bond proceeds plus a bond premium of \$8,945,752 were used to defease \$49,060,000 of the Series 2005A Utility System Revenue Improvement and Refunding Bonds; \$27,815,000 of the Series 2005B Utility System Revenue Refunding Bonds; \$5,480,000 of the Series 2011 Utility System Revenue Refunding Bonds; and \$20,000,000 of the Utilities System Commercial Paper Notes.

On May 15, 2016, the Public Utilities Board issued \$39,410,000 in Utilities System Revenue Refunding Bonds, Series 2016. The refunding bond proceeds plus a bond premium of \$7,705,681 were used to defease \$42,505,000 of the Series 2008 Utility System Revenue Refunding Bonds. As a result, the refunded debt is considered to be defeased and the liability was been removed from long-term debt.

(b) Current Refunding

The Public Utilities Board issued \$94,770,000 in aggregate principal amount of Utilities System Revenue Refunding Bonds, Series 2015. Part of the proceeds of the refunding bonds were used for a current refunding of \$20,000,000 of Commercial Paper Notes. As a result, the refunded commercial paper notes are considered to be defeased and the liability has been removed from long-term debt. This current refunding was undertaken to convert the Commercial Paper Notes to long-term and did not result in an economic gain or loss.

(c) Advance Refunding

The Public Utilities Board issued \$39,410,000 in aggregate principal amount of Utilities System Revenue Refunding Bonds, Series 2016. The refunding bonds were issued to provide resources to purchase U.S. Government State and Local Government Series securities that were placed in an irrevocable trust for the purpose of generating resources for all future debt service payments of \$42,505,000 of the Series 2008 Utilities System Revenue Refunding Bonds for the years 2019 through 2033. As a result, the refunded bonds are considered to be defeased and the liability has been removed from long-term debt. The reacquisition price exceeded the net carrying amount of the old debt by \$4,956,383. This amount together with \$576,913 of unamortized deferred amount from the prior refunding is being netted against the new debt and amortized through the year 2033. The Public Utilities Board completed the advance refunding to reduce its total debt service payments over the next 18 years by \$6,380,112 and to obtain an economic gain (difference between the present values of the old and new debt service payments) of \$5,282,797.

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(6) LONG-TERM DEBT – Continued

(c) *Advance Refunding – Continued*

The Public Utilities Board issued \$94,770,000 in aggregate principal amount of Utilities System Revenue Refunding Bonds, Series 2015. The refunding bonds were issued to provide resources to purchase U.S. Government State and Local Government Series securities \$49,060,000 of the Series 2005A Utilities System Revenue Improvement and Refunding Bonds for the years 2016 through 2031, \$27,815,000 of the Series 2005B Utility System Revenue Refunding Bonds for the years 2016 through 2019 and \$5,480,000 of the Series 2011 Utility System Revenue Refunding Bonds for the years 2016 through 2019. As a result, the refunded bonds are considered to be defeased and the liability has been removed from long-term debt. The reacquisition price exceeded the net carrying amount of the old debt by \$1,223,175. This amount together with \$935,149 of unamortized deferred amount from the prior refunding is being netted against the new debt and amortized through the year 2031. The Public Utilities Board completed the advance refunding to reduce its total debt service payments over the next 16 years by \$10,352,811 and to obtain an economic gain (difference between the present values of the old and new debt service payments) of \$8,445,383.

(d) *Prior Year Defeasance of Debt*

In prior years, the Public Utilities Board has defeased various bond issues by creating separate irrevocable trust funds. New debt has been issued and the proceeds have been used to purchase U.S. government securities that were placed in the trust funds. The investments and fixed earnings from the investments are sufficient to fully service the defeased debt until the debt is called or it matures. For financial reporting purposes, the debt has been considered defeased and therefore removed as a liability from long-term debt. As of September 30, 2016 and 2015, the amount of defeased debt outstanding but removed from long-term debt amounted to \$54,620,000 and \$20,775,000, respectively.

(e) *Remarketing Memorandum*

In connection with the Public Utilities Board restructuring of its revenue financing system, the Public Utilities Board approved a Remarketing Memorandum which became effective upon the issuance of the 2005 Bonds. The Remarketing Memorandum modified certain existing covenants of the Utilities System Subordinate Lien Revenue and Refunding Bonds, Series 2002A and 2002B to conform to the terms on which the Series 2005 Bonds were issued.

(7) RISK MANAGEMENT

The Public Utilities Board is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; and natural disasters for which the entity carries commercial insurance. The Public Utilities Board has established a limited risk management program for employee health and workers' compensation for which the Public Utilities Board retained risk of loss. For insured programs, there have been no significant reductions in insurance coverage. Liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. Liabilities include an amount for claims incurred but not reported. The result of the process to estimate the claims liability is not an exact amount as it depends on many complex factors, such as inflation, changes in legal doctrines, and damage awards. Accordingly, claims are reevaluated periodically. The estimate of the

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(7) RISK MANAGEMENT – Continued

claims liability also includes amounts for claim incremental adjustment expenses. Estimated recoveries from third parties are another component of claims expense. Excess coverage insurance policies cover individual claims in excess of \$145,000 and \$350,000 (each Accident) / \$1,050,000 (Aggregate) for health and workers' compensation, respectively. Settlement amounts have not exceeded insurance coverage for the current year or the three prior years.

(a) Workers' Compensation Program

The Public Utilities Board has a workers' compensation self-insurance plan for the purpose of providing medical and indemnity payments as required by law for on-the-job related injuries. The plan is administered by a service agent. The Public Utilities Board has an excess workers' compensation insurance contract with an insurance carrier coverage which provides Texas statutory limits for claims in excess of \$350,000 for any one accident or occurrence. The aggregate deductible under this policy is \$1,050,000. Management feels that the contributions made during the year for workers' compensation will offset any claims paid during the year. Therefore, the entire liability is estimated to be long term and recorded as such.

(b) Health Insurance Program

The Public Utilities Board has a group health self-insurance plan for the purpose of providing health insurance for the employees and their dependents. The plan is administered by a service agreement. The Public Utilities Board has a stop loss insurance contract with an insurance carrier covering claims in excess of \$145,000 per individual. The Public Utilities Board also has aggregate limits, which fluctuate based on enrollment but that are currently set at \$7,820,334. This figure would be the Board's maximum liability, including claims and fixed cost for the 2017 Plan Year.

The following is a summary of changes in claims liability for the Workers' Compensation and Health Insurance programs, which is included in accounts payable and accrued liabilities payable from restricted assets, for the years ended September 30, 2016 and 2015:

	Beginning Balance 2015	Claims and Adjustments	Claims Payments	Ending Balance 2016	Amounts Due Within One Year
Workers' Compensation	\$ 212,734	\$ 745,618	\$ (825,057)	\$ 133,295	\$ 90,870
Health Insurance	\$ 114,663	\$ 5,447,108	\$ (5,427,099)	\$ 134,672	\$ 134,672

	Beginning Balance 2014	Claims and Adjustments	Claims Payments	Ending Balance 2015	Amounts Due Within One Year
Workers' Compensation	\$ 115,215	\$ 386,377	\$ (288,858)	\$ 212,734	\$ 143,657
Health Insurance	\$ 115,200	\$ 4,714,055	\$ (4,714,592)	\$ 114,663	\$ 114,663

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(8) TEXAS MUNICIPAL RETIREMENT SYSTEM

(a) Plan Description

The Public Utilities Board participates as one of 860 plans in the nontraditional, joint contributory, hybrid defined benefit pension plan administered by the Texas Municipal Retirement System (TMRS). TMRS is an agency created by the State of Texas and administered in accordance with the TMRS Act,

Subtitle G, Title 8, Texas Government Code (the TMRS Act) as an agent multiple-employer retirement system for municipal employees in the State of Texas. The TMRS Act places the general administration and management of the System with a six-member Board of Trustees. Although the Governor, with the advice and consent of the Senate, appoints the Board, TMRS is not fiscally dependent on the State of Texas. TMRS's defined benefit pension plan is a tax-qualified plan under Section 401 (a) of the Internal Revenue Code. TMRS issues a publicly available comprehensive annual financial report (CAFR) that can be obtained at www.tmrs.com.

The plan provisions are adopted by the governing body of the Public Utilities Board, within the options available in the state statutes governing TMRS and within the actuarial constraints in the statutes. All eligible employees of the Public Utilities Board are required to participate in the TMRS.

Plan provisions for the Public Utilities Board were as follows:

Employee deposit rate:	7%
Matching ratio (PUB to employee):	2 to 1
Years required for vesting:	5 years
Members can retire at certain ages, based on the years of service with the Public Utilities Board. The Service Retirement Eligibilities for the Public Utilities Board are:	5 years/age 60 20 years/any age
Updated Service Credit	100% Repeating, Transfers
Annuity Increase (to retirees)	70% of CPI Repeating

(b) Benefits Provided

TMRS provides retirement, disability, and death benefits. Benefit provisions are adopted by the governing body of the Public Utilities Board, within the options available in the state statutes governing TMRS.

At retirement, the benefit is calculated as if the sum of the employee's contributions, with interest, and the Public Utilities Board-financed monetary credits with interest were used to purchase an annuity. Members may choose to receive their retirement benefit in one of seven payment options. Members may also choose to receive a portion of their benefit as a Partial Lump Sum Distribution in an amount equal to 12, 24, or 36 monthly payments, which cannot exceed 75% of the member's deposits and interest.

At the date the plan began, the Public Utilities Board granted monetary credits for service rendered before the plan began of a theoretical amount equal to two times what would have been contributed

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(8) TEXAS MUNICIPAL RETIREMENT SYSTEM – Continued

(b) Benefits Provided – Continued

by the employee, with interest, prior to establishment of the plan. Monetary credits for service since the plan began are a percentage (100%, 150%, or 200%) of the employee’s accumulated contributions. In addition, the Public Utilities Board can grant, as often as annually, another type of monetary credit referred to as an updated service credit which is a theoretical amount which, when added to the employee’s accumulated contributions and the monetary credits for service since the plan began, would be the total monetary credits and employee contributions accumulated with interest if the current employee contribution rate and the Public Utilities Board matching percent had always been in existence and if the employee’s salary had always been the average of his salary in the last three years that are one year before the effective date.

At the December 31 valuation and measurement date, the following employees were covered by the benefit terms:

	December 31,	
	2015	2014
Active employees	570	562
Inactive employees or beneficiaries currently receiving benefits	240	232
Inactive employees entitled to but not yet receiving benefits	99	84
Total Plan Participants	909	878

(c) Contributions

The contribution rates for employees in TMRS are either 5%, 6%, or 7% of employee gross earnings, and the Public Utilities Board matching percentages are either 100%, 150%, or 200%, both as adopted by the governing body of the Public Utilities Board. Under the state law governing TMRS, the contribution rate for each entity is determined annually by the actuary, using the Entry Age Normal (EAN) actuarial cost method. The actuarially determined rate is the estimated amount necessary to finance the cost of benefits earned by employees during the year, with an additional amount to finance any unfunded accrued liability.

Employees of the Public Utilities Board were required to contribute 7% of their annual gross earnings during the fiscal year. The contribution rates for the Public Utilities Board were 13.25% and 12.12% for calendar years 2015 and 2016, respectively. The Public Utilities Board’s contributions to TMRS in the fiscal year ended September 30, 2016, were \$4,339,028, and \$3,534,419, for fiscal year ended September 30, 2015, and equaled the required contributions.

(d) Net Pension Liability

The Public Utilities Board’s net pension liability (NPL) was measured as of December 31, 2015, and total pension liability (TPL) used to calculate the net pension liability was determined by actuarial valuations as of that date.

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(8) TEXAS MUNICIPAL RETIREMENT SYSTEM – Continued

(d) Net Pension Liability - Continued

Actuarial assumptions

The total pension liability in the December 31, 2015 actuarial valuation was determined using the following actuarial assumptions:

Inflation	2.5% per year
Overall payroll growth	3.0% per year
Investment Rate of Return	6.75%

Salary increases were based on a service-related table. Mortality rates for active members, retirees, and beneficiaries were based on the gender-distinct RP2000 Combined Healthy Mortality Table, with male rates multiplied by 109% and female rates multiplied by 103%. The rates are projected on a fully generational basis by scale BB to account for future mortality improvements. For disabled annuitants, the gender-distinct RP2000 Disabled Retiree Mortality Table is used, with slight adjustments.

These actuarial assumptions were developed primarily from the actuarial investigation of the experience of TMRS over the four year period from December 31, 2010 to December 31, 2014. They were adopted in 2015 and first used in the December 31, 2015 actuarial valuation. The post-retirement mortality assumption for healthy annuitants and Annuity Purchase Rate (APRs) are based on the Mortality Experience Investigation Study covering 2009 through 2011 and dated December 31, 2013. In conjunction with these changes first used in the December 31, 2013 valuation, the System adopted the Entry Age Normal actuarial cost method and a one-time change to the amortization policy. These assumptions apply to both the Pension Trust and the Supplemental Death Benefits Fund as applicable. Assumptions are reviewed annually.

The long-term expected rate of return on pension plan investments is 6.75%. The pension plan's policy in regard to the allocation of invested assets is established and may be amended by the TMRS Board of Trustees. Plan assets are managed on a total return basis with an emphasis on both capital appreciation as well as the production of income, in order to satisfy the short-term and long-term funding needs of TMRS.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation.

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(8) TEXAS MUNICIPAL RETIREMENT SYSTEM – Continued

(d) Net Pension Liability - Continued

Actuarial assumptions – Continued

The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

<u>Asset Class</u>	<u>Target Allocation</u>	<u>Long-Term Expected Real Rate of Return (Arithmetic)</u>
Domestic Equity	17.5%	4.55%
International Equity	17.5%	6.1%
Core Fixed Income	10.0%	1.0%
Non-Core Fixed Income	20.0%	3.65%
Real Return	10.0%	4.03%
Real Estate	10.0%	5.0%
Absolute Return	10.0%	4.0%
Private Equity	<u>5.0%</u>	8.0%
Total	<u>100.0%</u>	

Discount Rate

The discount rate used to measure the Total Pension Liability was 6.75%. The projection of cash flows used to determine the discount rate assumed that employee and employer contributions will be made at the rates specified in statute. Based on that assumption, the pension plan's Fiduciary Net Position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the Total Pension Liability.

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September 30, 2016 and 2015

(8) TEXAS MUNICIPAL RETIREMENT SYSTEM – Continued

(d) Net Pension Liability - Continued

The Public Utilities Board's changes in net pension liability were as follows:

	Increase (Decrease)		
	Total Pension Liability (a)	Plan Fiduciary Net Position (b)	Net Pension Liability (a) - (b)
Balance at 12/31/2014	\$ 134,070,282	\$ 120,253,874	\$ 13,816,408
Changes for the year:			
Service cost	3,748,945	-	3,748,945
Interest	10,202,003	-	10,202,003
Change of benefit terms	12,418,650	-	12,418,650
Difference between expected and actual experience	(976,625)	-	(976,625)
Changes in assumptions	119,380	-	119,380
Contributions - employer	-	3,483,411	(3,483,411)
Contributions - employee	-	1,840,296	(1,840,296)
Net investment income	-	177,458	(177,458)
Benefit payments, including refunds of employee contributions	(5,240,997)	(5,240,997)	-
Administrative expense	-	(108,080)	108,080
Other changes	-	(5,338)	5,338
Net changes	20,271,356	146,750	20,124,606
Balance at 12/31/2015	<u>\$ 154,341,638</u>	<u>\$ 120,400,624</u>	<u>\$ 33,941,014</u>

Sensitivity of the Net Pension Liability to Changes in the Discount Rate

The following presents the net pension liability of the Public Utilities Board, calculated using the discount rate of 6.75%, as well as what the Public Utilities Board's net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (5.75%) or 1-percentage-point higher (7.75%) than the current rate:

1% Decrease 5.75%	Current Single Rate 6.75%	1% Increase 7.75%
\$ 56,716,812	\$ 33,941,014	\$ 15,288,581

Pension Plan Fiduciary Net Position

Detailed information about the pension plan's Fiduciary Net Position is available in a separately-issued TMRS financial report. That report may be obtained on the Internet at www.tmrs.com.

(e) Pension Expense and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

The Public Utilities Board recognized \$17,681,051 in pension expense for the fiscal year ended September 30, 2016.

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September 30, 2016 and 2015

(8) TEXAS MUNICIPAL RETIREMENT SYSTEM – Continued

(e) Pension Expense and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions – Continued

At September 30, 2016, the Public Utilities Board reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	September 30,	
	2016	2015
<u>Deferred outflows of resources</u>		
Differences between projected and actual earnings on pension assets	\$ 7,465,604	\$ 1,164,471
Employer's contributions to the Plan subsequent to the measurement of total pension liability	3,545,797	2,690,180
Total deferred outflows of resources	\$ 11,011,401	\$ 3,854,651
<u>Deferred inflows of resources</u>		
Differences between projected and actual earnings on pension assets	\$ (2,484,829)	\$ (2,009,154)
Changes in assumptions	101,509	~
Total deferred inflows of resources	\$ (2,383,320)	\$ (2,009,154)

The amount reported as deferred outflows of resources, \$3,545,797, related to pensions resulting from contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability for the year ending September 30, 2017. Other amounts reported as deferred outflows and inflows of resources related to pensions will be recognized in pension expense as follows:

Year ended	Net deferred
<u>December 31:</u>	outflows (inflows)
	of resources:
2016	\$ 1,456,102
2017	1,456,102
2018	1,456,101
2019	1,164,983
2020	(363,739)
Thereafter	(87,265)
Total	\$ 5,082,284

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(9) OTHER POST-EMPLOYMENT BENEFITS

In addition to the pension benefits described in Note 8, the Public Utilities Board provides post-retirement health care benefits and supplemental death benefits to its employees.

POST-RETIREMENT HEALTH CARE BENEFITS

(a) Plan Description

The Public Utilities Board provides post-retirement health care benefits for employees retiring and receiving annuities from the Texas Municipal Retirement System, through a single-employer plan, who are (1) at least age 60 and have completed 10 consecutive years of active service with the Public Utilities Board immediately prior to retirement, (2) at least age 55 and have completed 25 consecutive years of active service with the Public Utilities Board immediately prior to retirement, or (3) at any age having completed 30 consecutive years of active service with the Public Utilities Board immediately prior to retirement. Prior to age 65, the Public Utilities Board will pay 100% of the cost of the Group Health Insurance Program for the retirees. Spouses and dependents are also eligible for coverage, but the retiree must pay the premiums. No coverage is available after the retiree reaches age 65, including coverage for spouses and dependents. The above eligibility and coverage requirements do not apply to retirees that retired under Retiree Package I (1999) and Retiree Package II (2005). The Retiree Package I plan results from a special offer made in fiscal year 1999 to all employees with 25 years or more of credited service or eligible for retirement under TMRS guidelines who elected to voluntarily resign or retire during the offer period. The plan provides coverage for the employees and the employees' dependent (spouse) under the Public Utilities Board's group medical plan until such time as the employee becomes 65 years of age, dies, or elects to receive coverage from another source. Under Retiree Package I, 34 retirees met these eligibility requirements. The Retiree Package II plan provides post-retirement benefits to all employees who retire from the Public Utilities Board after attaining 10 years of service and 60 years of age, 25 years of service and 55 years of age or 30 years of service regardless of age. Under the Retiree Package II plan, retirees may pay to provide spousal and dependent coverage.

Under Retiree Package II, 24 retirees met these eligibility requirements. The Public Utilities Board provides 100% of the cost of retirees to participate in this plan. Expenses for post-retirement health care benefits are recognized as retirees report claims and include a provision for estimated claims incurred but not yet reported. Expenses related to provision of these post-employment benefits cannot be reasonably estimated.

(b) Actuarial Methods and Assumptions

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. Examples include assumptions as to rates of interest, mortality, and turnover. Actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future.

The required schedule of funding progress immediately following the notes to the financial statements presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

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(9) OTHER POST-EMPLOYMENT BENEFITS - Continued

POST-RETIREMENT HEALTH CARE BENEFITS - Continued

(b) Actuarial Methods and Assumptions - Continued

Calculations are based on the types of benefits provided under the terms of the substantive plan at the time of each valuation and on the pattern of sharing of costs between the employer and plan members to that point. The projection of benefits for financial reporting purposes does not explicitly incorporate the potential effects of legal or contractual funding limitations on the pattern of cost sharing between the employer and plan members in the future. Actuarial calculations reflect a long-term perspective.

The actuarial methods and significant assumptions used to determine the Annual Required Contribution (ARC) for the current year are as follows:

- 1) Measurement date is as of October 1, 2015.
- 2) The actuarial cost method used is the projected unit credit cost method.
- 3) As of this valuation date, there are no assets, hence no need for an actuarial value of assets.
- 4) The amortization method is level percent of payroll. The amortization period is 30 years. The period is open.
- 5) See below for a disclosure of the significant actuarial assumptions.
 - Discount Rate for Valuing Liabilities
 - Without prefunding: 3.50% per annum, compounded annually
 - Inflation Rate
 - 2.30% per annum, compounded annually
 - Payroll Growth
 - 2.10% per annum, compounded annually
 - Mortality Rates
 - Pre-retirement: Sex Distinct RP-2014 Mortality Table adjusted to 2006 with Projection Scale MP-2016
 - Post-retirement: Sex Distinct RP-2014 Mortality Table adjusted to 2006 with Projection Scale MP-2016
 - Disability Rates
 - From December 31, 2015 TMRS report:

Age	Male	Female
35	0.0259%	0.0259%
40	0.0494%	0.0494%
45	0.0804%	0.0804%
50	0.1188%	0.1188%
55	0.1647%	0.1647%
60	0.2180%	0.2180%

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(9) OTHER POST-EMPLOYMENT BENEFITS - Continued
POST-RETIREMENT HEALTH CARE BENEFITS - Continued

(b) Actuarial Methods and Assumptions - Continued

- Withdrawal Rates
 - 2003 SOA Pension Plan Turnover Study adjusted by 60.3%:

Age	Male	Female
25	11.2%	11.2%
30	7.4%	7.4%
35	5.3%	5.3%
40	4.2%	4.2%
45	3.7%	3.7%
50	3.4%	3.4%
55	1.8%	1.8%
60	1.3%	1.3%

- Retirement Rates
 - From December 31, 2015 TMRS report for entry ages 32 & under:

Ages	Male	Female
40-44	6%	6%
45-49	6%	6%
50-53	8%	8%
54	8%	11%
55-59	14%	11%
60	20%	14%
61	25%	28%
62	32%	28%
63	32%	28%
64	32%	28%
65	32%	28%
66-69	22%	22%
70-74	20%	22%
75+	100%	100%

PUBLIC UTILITIES BOARD OF THE CITY OF BROWNSVILLE, TEXAS
(A Component Unit of the City of Brownsville, Texas)

Notes to Financial Statements

September 30, 2016 and 2015

(9) OTHER POST-EMPLOYMENT BENEFITS - Continued
POST-RETIREMENT HEALTH CARE BENEFITS - Continued

(b) Actuarial Methods and Assumptions – Continued

- Participation Assumption
 - 100% of active employees are assumed to elect coverage at retirement.
- Marriage Assumption
 - For actives it is assumed that husbands are three years older than their wives. 50% of active participants making it to retirement are assumed to be married and elect spouse coverage.
- Claims Costs at Sample Ages – Annual

Age	Retiree		Spouse	
	Male	Female	Male	Female
45	10,091	11,588	7,011	8,349
50	8,864	10,002	7,868	9,096
55	9,352	9,819	9,051	9,929
60	11,399	11,142	10,826	11,114
64	14,218	12,843	13,119	12,445
65+	0	0	0	0

- Medical Inflation (Trend Assumption)
 - The trend assumptions for medical and pharmacy costs and retiree premiums are summarized below:

Year	Trend
2015	6.00%
2016	6.00%
2017	5.80%
2018	5.60%
2019	5.30%
2020-2021	5.20%
2022	5.10%
2023-2024	5.00%
2025-2029	4.90%
2030-2032	5.00%
2033-2036	5.20%
2037-2038	5.30%

Year	Trend
2039	5.20%
2040-2041	5.10%
2042	5.30%
2043-2046	5.60%
2046-2048	5.50%
2049-2050	5.40%
2051-2055	5.30%
2056-2060	5.20%
2061-2063	5.10%
...	...
2073-2076	4.20%
2077+	4.10%

PUBLIC UTILITIES BOARD OF THE CITY OF BROWNSVILLE, TEXAS
(A Component Unit of the City of Brownsville, Texas)

Notes to Financial Statements

September 30, 2016 and 2015

(9) OTHER POST-EMPLOYMENT BENEFITS- Continued

POST-RETIREMENT HEALTH CARE BENEFITS- Continued

(c) Annual OPEB Cost and Net OPEB Obligation

The Public Utilities Board's annual other post-employment benefit (OPEB) cost is calculated based on the ARC of the employer, an amount actuarially determined in accordance with the parameters of GASB Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years. The annual OPEB cost consists of the ARC, interest on the net OPEB obligation, and adjustments to the ARC. The September 30, 2015, and September 30, 2016, actuarial valuations are the basis for the annual OPEB cost of \$1.3 million and \$1.6 million, respectively.

The following table shows the components of the Public Utilities Board's annual OPEB cost for FY 2016 and FY 2015, the contributions in relation to the ARC, and changes in the net OPEB obligation. The net OPEB obligation may be either positive, reflecting a liability, or negative, reflecting an asset. The term net OPEB obligation, as used in this note, refers to either situation.

<u>Determination of Annual Required Contribution</u>	<u>9/30/2015</u>	<u>9/30/2016</u>
Normal Cost at fiscal year end	\$ 759,346	\$ 934,587
Amortization of UAAL	509,043	676,825
Annual Required Contribution (ARC)	<u>\$ 1,268,389</u>	<u>\$ 1,611,412</u>
<u>Determination of Net OPEB Obligation</u>		
Net OPEB Obligation - beginning of year	\$ 6,970,707	\$ 7,866,350
Annual Required Contribution	1,268,389	1,611,412
Interest on prior year Net OPEB Obligation	243,975	275,322
Adjustment to ARC	(290,968)	(328,353)
Annual OPEB Cost	<u>1,221,396</u>	<u>1,558,381</u>
Contributions in relation to ARC	<u>(325,753)</u>	<u>(750,009)</u>
Increase in Net OPEB Obligation	895,643	808,372
Net OPEB Obligation - end of year	<u>\$ 7,866,350</u>	<u>\$ 8,674,722</u>

PUBLIC UTILITIES BOARD OF THE CITY OF BROWNSVILLE, TEXAS
(A Component Unit of the City of Brownsville, Texas)

Notes to Financial Statements

September 30, 2016 and 2015

(9) OTHER POST-EMPLOYMENT BENEFITS - Continued

POST-RETIREMENT HEALTH CARE BENEFITS - Continued

(c) Annual OPEB Cost and Net OPEB Obligation – Continued

The following table shows the estimated annual OPEB cost and net OPEB obligation for the prior three years under a plan which is not prefunded:

Fiscal Year Ended	Discount Rate	Annual OPEB Cost	Employer Contributions	Percentage of OPEB Cost Contributed	Net OPEB Obligation
9/30/2014	3.50%	\$ 1,228,964	\$ 106,320	8.65%	\$ 6,970,707
9/30/2015	3.50%	\$ 1,221,396	\$ 325,753	26.67%	\$ 7,866,350
9/30/2016	3.50%	\$ 1,558,381	\$ 750,009	48.13%	\$ 8,674,722

(d) Funded Status and Funding Progress

As of October 1, 2015, the most recent actuarial valuation date, the plan was zero percent funded. The actuarial accrued liability for benefits was \$16.2 million, and the actuarial value of assets was zero, resulting in an unfunded actuarial accrued liability (UAAL) of \$16.2 million. The covered payroll (annual payroll of active employees covered by the plan) was \$26.3 million, and the ratio of the UAAL to the covered payroll was 61.7 percent.

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liabilities (AAL)⁽¹⁾	Unfunded Actuarial Accrued Liabilities (UAAL)⁽²⁾	Funded Ratio	Covered Payroll	UAAL as a % of Covered Payroll
10/1/2013	\$ -	\$ 12,195,117	\$ 12,195,117	0.00%	\$ 22,199,991	54.9%
10/1/2014	\$ -	n/a	n/a	0.00%	n/a	n/a
10/1/2015	\$ -	\$ 16,214,696	\$ 16,214,696	0.00%	\$ 26,289,939	61.7%

(1) Actuarial Accrued Liability determined under the projected unit credit cost method based on a discount rate of 3.50% as of October 1, 2013. A valuation was not performed for the fiscal year beginning October 1, 2014, so liabilities were carried forward from the October 1, 2013 valuation. Actuarial Accrued Liability determined under the projected unit credit cost method based on a discount rate of 3.50% as of October 1, 2015.

(2) Actuarial Accrued Liability less Actuarial Value of Assets.

PUBLIC UTILITIES BOARD OF THE CITY OF BROWNSVILLE, TEXAS
(A Component Unit of the City of Brownsville, Texas)

Notes to Financial Statements

September 30, 2016 and 2015

(9) OTHER POST-EMPLOYMENT BENEFITS - Continued

POST-RETIREMENT HEALTH CARE BENEFITS - Continued

(d) Funded Status and Funding Progress - Continued

The Schedule of Funding Progress, presented as RSI following the notes to the financial statements, presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing relative to the actuarial accrued liability for benefits over time.

Management feels that the contributions made during the year to other post-employment benefits will offset any claims paid during the year. Therefore, the entire liability is estimated to be long term and recorded as such. All assumptions for the postretirement benefits valuation as of October 1, 2015, are contained in the Public Utilities Board Actuarial Valuation Report, a copy of which may be obtained by writing to P.O. Box 3270, Brownsville, Texas 78523-3270.

SUPPLEMENTAL DEATH BENEFIT PLAN

(a) Plan Description

The Public Utilities Board also participates in the cost sharing multiple-employer defined benefit group-term life insurance plan operated by the TMRS known as the Supplemental Death Benefits Fund (SDBF). The Public Utilities Board elected, by ordinance, to provide group-term life insurance coverage to both current and retired employees. The Public Utilities Board may terminate coverage under and discontinue participation in the SDBF by adopting an ordinance before November 1 of any year to be effective the following January 1. The death benefit for active employees provides a lump-sum payment approximately equal to the employees' annual salary (calculated based on the employees actual earnings, for the 12-month period preceding the month of death); retired employees are insured for \$7,500; this coverage is an "other postemployment benefit," or OPEB.

(b) Contributions

The Public Utilities Board contributes to the SDBF at a contractually required rate as determined by an annual actuarial valuation. The rate is equal to the cost of providing one-year term life insurance. The funding policy for the SDBF program is to assure that adequate resources are available to meet all death benefit payments for the upcoming year; the intent is not to prefund retiree term life insurance during employees' entire careers.

See schedule of contribution rates below:

PUBLIC UTILITIES BOARD OF THE CITY OF BROWNSVILLE, TEXAS
(A Component Unit of the City of Brownsville, Texas)

Notes to Financial Statements

September 30, 2016 and 2015

(9) OTHER POST-EMPLOYMENT BENEFITS - Continued
SUPPLEMENTAL DEATH BENEFIT PLAN – Continued

(b) Contributions - Continued

Schedule of Contribution Rates
(RETIREE-only portion of the rate)

Actuarial Cost Method and Assumptions

Plan/ Calendar Year	Annual Required Contribution (Rate)	Actual Contribution Made (Rate)	Percentage of ARC Contributed
2014	0.06%	0.06%	100.0%
2015	0.06%	0.06%	100.0%
2016	0.05%	0.05%	100.0%

(c) Actuarial Cost Method and Assumptions

Actuarial information under this plan is as follows:

Valuation date	12/31/2015
Actuarial cost method	Entry Age Normal
Amortization method	Level percent of payroll
Amortization period	25 years – open period
Asset valuation method	Fund value
Assumptions	
Investment return	4.25%
Projected salary increases	None
Inflation	3.0%
Cost-of-living adjustments	None

Three-year trend information follows:

Calendar Year Ending	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
December 31, 2013	\$ 41,848	100%	-
December 31, 2014	\$ 46,253	100%	-
December 31, 2015	\$ 47,322	100%	-

PUBLIC UTILITIES BOARD OF THE CITY OF BROWNSVILLE, TEXAS
(A Component Unit of the City of Brownsville, Texas)

Notes to Financial Statements

September 30, 2016 and 2015

(9) OTHER POST-EMPLOYMENT BENEFITS - Continued

SUPPLEMENTAL DEATH BENEFIT PLAN – Continued

(c) Actuarial Cost Method and Assumptions - Continued

The Public Utilities Board has the benefit plan administered by TMRS. The Public Utilities Board has an annual, individual actuarial valuation performed. All assumptions for the December 31, 2015 valuations are contained in the 2015 TMRS Comprehensive Annual Financial Report, a copy of which may be obtained by writing to P.O. Box 149153, Austin, Texas 78714-9153 or may be obtained from TMRS' website at www.TMRS.com.

(10) RELATED PARTY TRANSACTION

The Public Utilities Board supplies electric, water, and wastewater services to the City without charge; this is in compliance with the provisions of the City charter. These services are accounted for in accordance with the Public Utilities Board's municipal rate schedules. Utilities service provided to the City for the years ended September 30, 2016 and 2015 were \$4,804,112 and \$4,809,741, respectively.

The Public Utilities Board also bills and collects the City's fees for garbage collection services, garbage tax, EPA fees, and maintenance services, and receives a 3% administrative fee for these services except garbage tax. The Public Utilities Board charged \$775,830 and \$758,950 to the City for these collection services in 2016 and 2015, respectively.

(11) TRANSFERS TO THE CITY

The issuance of the 2005A and 2005B refunding bonds modified certain existing covenants which included the calculation of the transfers to the City. Beginning fiscal year 2006 the transfers to the City are being made on a quarterly basis calculated at ten percent (10%) of the gross revenues received for the preceding fiscal year quarter, as adjusted in accordance with the following: (1) prior to applying the percentage set forth above to determine the amount to be transferred to the City, the amount of gross revenues for a fiscal year quarter shall be reduced by an amount equal to all costs for the purchase of power and fuel paid or incurred by the Public Utilities Board during such fiscal year quarter as well as funding requirements for the Southmost Regional Water Authority; and (2) the amount of funds to be transferred to the City shall be reduced by any amounts owed by the City to the Public Utilities Board for utility services. Prior to fiscal year 2006 Article VI of the Charter provided for the transfer to the City's general fund by the Public Utilities Board from "Surplus Funds" available at the close of each fiscal year (after retaining in the Plant Fund an amount deemed by the Public Utilities Board to be sufficient to pay system operation and maintenance expenses for the next 60 days), to the extent available, the greater of \$400,000 or 50% of such surplus funds. Surplus funds, as defined in the Charter, are amounts remaining in the Plant Fund at the close of each fiscal year after all Charter requirements and after all payments have been fully and timely made into funds created by ordinances authorizing outstanding bonds secured by a pledge of the system's net revenues.

Required payments to the City for the years ended September 30, 2016 and 2015 totaled \$9,822,602 and \$9,040,104, respectively, of which \$2,748,853 and \$2,772,669, respectively, was payable at September 30, 2016 and 2015.

PUBLIC UTILITIES BOARD OF THE CITY OF BROWNSVILLE, TEXAS
(A Component Unit of the City of Brownsville, Texas)

Notes to Financial Statements

September 30, 2016 and 2015

(12) COMMITMENTS AND CONTINGENCIES

The Public Utilities Board is currently involved in various claims and litigation. It is the opinion of management and counsel that potential claims against the Public Utilities Board not covered by insurance resulting from litigation would not materially affect the financial position or operations of the Public Utilities Board.

At September 30, 2016, the Public Utilities Board had committed approximately \$13,236,008 for utility plant expansion and improvements. Funding of these amounts will come from available revenues of the Public Utilities Board and restricted funds.

(13) PENDING GASBs

As of September 30, 2016, the Governmental Accounting Standards Board (GASB) had issued statements not yet implemented by the Public Utilities Board. The statements which might impact the Public Utilities Board are as follows:

GASB Statement No. 74, *Financial Reporting for Post-Employment Benefit Plans Other Than Pension Plans*, (Effective beginning FY 10/1/2016) replaces Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plan*, as they relate to certain other postemployment benefit ("OPEB") plans that are administered through trusts or equivalent arrangements. This Statement requires more extensive note disclosures and RSI related to the measurement of the OPEB liabilities for which assets have been accumulated, including information about the annual money-weighted rates of return on plan investments.

GASB Statement No. 75, *Accounting and Financial Reporting for Post-Employment Benefits Other Than Pensions*, (Effective beginning FY 10/1/2017) replaces the requirements of Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, for OPEB. This Statement establishes new accounting and financial reporting requirements for governments whose employees are provided with OPEB, including the recognition and measurement of liabilities, deferred outflows of resources, deferred inflows of resources and expense. For each qualifying plan providing postemployment benefits other than pensions, employers are required to report the difference between the actuarial OPEB liability and the related plan's fiduciary net position as the net OPEB liability on the statement of net position. Previously, a liability was recognized only to the extent that contributions made to each plan were exceeded by the actuarially calculated contributions for those plans. Additionally, Statement No. 75 sets forth note disclosure and required supplementary disclosure requirements for defined contribution OPEB.

GASB Statement No. 77, *Tax Abatement Disclosures*, (Effective beginning FY 10/1/2016) provides financial disclosure requirements for governments that enter into tax abatement agreements. This Statement indicates how disclosures for tax abatements should be organized and what descriptive information, including commitments made by the entity should be presented. Because the Public Utilities

PUBLIC UTILITIES BOARD OF THE CITY OF BROWNSVILLE, TEXAS
(A Component Unit of the City of Brownsville, Texas)

Notes to Financial Statements

September 30, 2016 and 2015

(13) PENDING GASBs – Continued

Board is not a tax-levying government and is not a party to tax abatement agreements, there is no expected impact on the financial statements.

GASB Statement No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*, (Eff. Beg. 10/1/2016) clarifies requirements for the application of GASB Statement No. 68 for certain governments whose employees receive pension benefits through multiple-employer plans. As the Public Utilities Board does not sponsor benefits through the type of plan addressed by this Statement, the guidance is not applicable and will have no impact on the Company's financial reporting.

GASB Statement No. 80, *Blending Requirements for Certain Component Units – an amendment of GASB Statement No. 14*, (Effective beginning FY 10/1/2016) amends the blending requirements for the financial statement presentation of certain component units. The additional criterion requires blending of a component unit incorporated as a not-for-profit corporation in which the primary government is the sole corporate member. The additional criterion does not apply to component units included in the financial reporting entity pursuant to the provisions of GASB Statement No. 39, *Determining Whether Certain Organizations Are Component Units*. Because the component unit of the Public Utilities Board is not incorporated as a not-for-profit corporation, there is no expected impact on the financial statements.

(14) PRIOR PERIOD ADJUSTMENT

In fiscal year 2015, the Public Utilities Board adopted and implemented GASB Statement No. 68, *Accounting and Financial Reporting for Pensions an amendment of GASB Statement No. 27* and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date, an amendment of GASB Statement No. 68*, and recorded a prior period adjustment to reflect the effects of the guidance. The net effect of the prior period adjustment decreased net position by \$12,843,303. Amounts related to prior years were not readily determinable. Therefore, prior years are not restated.

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APPENDIX C

SOUTHMOST REGIONAL WATER AUTHORITY

WATER SUPPLY CONTRACT

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WATER SUPPLY CONTRACT
between
SOUTHMOST REGIONAL WATER AUTHORITY
and
BROWNSVILLE PUBLIC UTILITIES BOARD

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Exhibits

- Exhibit A - Delivery Points of the Participating Customers
- Exhibit B - Allocated Portion of the System Capacity of the Participating Customers
- Exhibit C - Description of the Initial Project

WATER SUPPLY CONTRACT

THIS WATER SUPPLY CONTRACT (this "Contract") is made and entered into as of the 12th day of December, 2002, between the SOUTHMOST REGIONAL WATER AUTHORITY, a conservation and reclamation district, a governmental agency and a body politic and corporate of the State of Texas created by Tex. Laws 1981, 67th Legislature, Regular Session, Chapter 511 (the "Act") and pursuant to Article XVI, Section 59 of the Texas Constitution (the "Authority") and the BROWNSVILLE PUBLIC UTILITIES BOARD, a utilities board established pursuant to the laws of the State of Texas and the Home Rule Charter of the City of Brownsville, Texas (the "Participating Customer").

RECITALS:

WHEREAS, the Authority was created by the Act for the purpose of controlling, storing, preserving, transmitting, treating, distributing and using water for municipal, domestic, industrial, and other beneficial uses inside and outside the boundaries of the Authority; and

WHEREAS, the Participating Customer needs to secure an additional source of supply of treated subsurface groundwater for its water distribution system to serve its present inhabitants and to provide for growth in the future; and

WHEREAS, the Authority and the Participating Customer are authorized by law to enter into contracts for the purpose of obtaining a treated water supply from the Authority under the terms set forth in this Contract; and

WHEREAS, the Authority has agreed to issue its Bonds (hereinafter defined) from time to time for the purpose of financing the cost of providing a water treatment and supply system during the Term of this Contract and, in consideration therefor, the Participating Customer has agreed to pay its share of all of the Authority's System Costs (as defined hereinafter) in connection therewith as provided for in this Contract.

NOW THEREFORE, in consideration of the premises, and for good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the Authority and the Participating Customer agree as follows:

ARTICLE I DEFINITIONS

Section 1.1. Definitions. For all purposes of this Contract, the following definitions of certain terms used herein shall apply:

"Acceptable Pressure" means the pressure at the Delivery Point not less than the minimum pressure of 60 psia.

"Accountant" shall mean a firm of independent, certified public accountants retained by the Authority which is experienced in auditing political subdivisions of the State.

"Act" is defined in the preamble to the Recitals to this Contract.

"Allocated Portion" shall mean in the case of the Brownsville Public Utilities Board, 92.92% of the System Capacity and with respect to the other Participating Customers, as indicated on Exhibit B, as amended in writing from time to time as permitted by the provisions of this Contract.

"Annual System Budget" is defined and described in Sections 4.2 and 4.3 of this Contract.

"Authority" shall mean the Southmost Regional Water Authority, or its Board of Directors as the context may indicate, and any legal successor which succeeds to the functions and authority thereof.

"Average Daily Rate" means a rate of delivery of water from the System delivered to the Participating Customer at the Delivery Point calculated as the average amount of water delivered on a daily basis over a 30 day period.

"Bonds" shall mean the Initial Project Bonds, as well as any other notes, bonds, refunding bonds and lease purchase obligations, or other revenue obligations issued from time to time by the Authority the proceeds of which are used for financing or refinancing allocable or attributable cost, expense or liability incurred or paid by the Authority for the financing, or refinancing, construction, reconstruction, acquisition, operation or maintenance of the System or otherwise paid or incurred by the Authority in order to perform its obligations under the Water Supply Contracts. "Bonds" shall include Bonds issued for any of the purposes described in Sections 8.1, 8.2 and 8.3, respectively. The term "Bonds" for the purposes of this Contract shall not include any Bonds, or any portion of an issue of Bonds, the proceeds of which are used for the purpose of constructing or acquiring Special Project Facilities as described in Section 8.4.

"Business Day" shall mean any day other than a Saturday, a Sunday, or a holiday on which banks in the State are closed.

"Capital Costs" shall mean all costs and expenses paid or incurred by the Authority for the financing of the System, including without limitation, the following:

(1) payments of principal of (whether upon maturity or earlier optional or mandatory redemption), redemption premium, if any, and interest which the Authority makes on all Bonds and any amounts which the Authority is required to fund into any sinking fund, debt service reserve fund or account under the terms of any bond resolution or indenture authorizing the issuance of any Bonds;

(2) amounts related to the Bonds and required under a bond resolution or indenture to be paid or deposited into any fund or account established by such bond resolution or indenture (other than funds and accounts referred to in clause (1) above), including any amounts required to be paid or deposited by reason of the transfer of moneys from such funds or accounts to the funds or accounts referred to in clause (1) above, provided that the Participating Customer shall receive credits against any amounts due under the preceding paragraph (1) or this paragraph (2) for investment earnings (net of any losses and expenses not incurred by the gross negligence of the authorized representative of the Authority), if any, on amounts deposited in any funds created under

or pursuant to such bond resolution or indenture and required to be paid by the Participating Customer under the preceding paragraph (1) or this paragraph (2);

(3) amounts which the Authority is required to pay under any bond insurance, credit agreements, standby purchase agreements, agreements with any trustee, escrow agent, tender agent, indexing agent or paying agent, or remarketing or similar costs related to the Bonds; and

(4) additional amounts which must be paid or collected by the Authority in order to meet the requirements of any rate covenant contained in a bond resolution or indenture with respect to coverage of principal of, premium, if any, and interest on the Bonds or to fulfill the terms of any agreement made with the holders of the Bonds and with any person on their behalf.

Capital Costs shall not include the Authority's debt service requirements or any payments made or incurred by the Authority to finance or refinance Special Project Facilities.

"Capital Cost Responsibility" shall refer to the percentage responsibility of the Participating Customer for Capital Costs.

"Commencement Date" shall mean the date on which the Allocated Portion of water meeting the quality standards set forth in this Contract, is first available for delivery to the Participating Customer at any Delivery Point of the Participating Customer.

"Consulting Engineers" shall mean NRS Consulting Engineers, for the water treatment plant, or any other qualified professional engineering firm employed by the Authority to advise the Authority concerning the design, construction, processing, operation or maintenance of the System.

"Contract" shall mean this Water Supply Contract, including any amendments or supplements hereto.

"Delivery Point" is defined in Section 5.1. The initial Delivery Points of all of the Participating Customers are listed on Exhibit "A".

"Effective Date" shall mean the date set forth on the first page of this Contract.

"Financial Advisor" shall mean First Southwest Company, or any other investment banking company or advisor employed by the Authority to advise the Authority concerning the issuance of Bonds or any financial aspects with respect to the System.

"Fiscal Year" shall mean the period of October 1 through September 30 of each year or such other period as is established from time to time by the Authority.

"Force Majeure" is defined in Section 6.7.

"Initial Project" is described on Exhibit "C" hereto.

"Initial Project Bonds" shall mean the Southmost Regional Water Authority Water Supply System Contract Revenue Bonds (Desalination Project), Series 2002, or any other series of bonds or obligations issued for the purpose of financing the costs of the Initial Project.

"Interlocal Cooperation Act" means Chapter 791, Vernon's Texas Government Code, as amended.

"MSRB" means the Municipal Securities Rulemaking Board and any successors to its duties.

"NRMSIR" means each person whom the SEC or its staff has determined to be a nationally recognized municipal securities information repository within the meaning of the Rule from time to time.

"Operating Costs" shall mean all costs and expenses, excluding Capital Costs and depreciation, paid or incurred by the Authority in connection with the ownership, operation or maintenance of the System and any repairs, renewals, replacements, additions, improvements, betterments and modifications to the System, including without limitation, the following:

(1) amounts which the Authority has paid or incurred for raw water or the withdrawal, lifting, treating, transportation or storage of raw water for delivery to the Participating Customers;

(2) amounts paid or incurred for the prevention or correction of any casualty loss or damage resulting from any cause whatsoever or for renewals, replacements, repairs, additions, improvements, betterments and modifications which the Authority determines are necessary to keep the System operating pursuant to Prudent Utility Practice, to provide adequate service or prevent a loss of revenues therefrom;

(3) amounts paid or incurred for the purpose of operating and maintaining the System and of delivering water therefrom including, but not limited to, payments for supplies, stores and three months reserve of the average cost of operation and maintenance of the System as estimated by the Authority's Consulting Engineer;

(4) all uninsured costs, including deductibles on insurance coverages, expenses, damages, or liabilities of whatsoever nature suffered by the Authority arising from its ownership or operation of the System, including without limitation all claims relating to personal injury, property damage, environmental damage and interruption of business, and costs of defense of claims paid by the Authority in connection with the System whether or not incurred as a result of the negligence of the Authority, its agents or employees, but excluding costs and expenses relating to claims required to be paid by the Authority in connection with the System to the extent arising out of gross negligence or willful misconduct of the Authority; and

(5) costs paid or incurred for any improvements to the System required by any local, State or Federal regulatory agency or State or Federal legislation; and

(6) all reasonable administrative and general expenses of the Authority incurred in connection with the System including, by way of illustration but not limitation, the following: salaries, wages, taxes, benefits and travel expenses of the Authority's employees, technical professionals, financial advisors and legal fees, premiums for liability, casualty and worker's compensation insurance, or fidelity bonds, or consumer, use, excise, property or other taxes or assessments, if any; postage and freight charges, long distance telephone charges and similar minor expenses, and other reasonable administrative expenses to the extent properly allocable and attributable to the operation of the System. In the absence of another standard for costs not directly expended for the operation and ownership of the System, the allocation and attribution shall be determined as a ratable amount for any period having the same proportion to total administrative and general expenses as the System Costs bears to gross operating revenues of the Authority from all activities.

The term "Operating Costs" shall not include the cost of operating or maintaining any Special Project Facilities or any costs of the type described in clauses (1) through (6) above allocable to Special Project Facilities.

"Participating Customer" is defined on the first page of this Contract.

"Participant's System" shall mean the water system or combined utility system of each Participating Customer, as applicable.

"Participating Customers," "each Participating Customer" or "any Participating Customer" shall mean, subject to the proviso in the definition of Water Supply Contract, one or more of the Participating Customers entered on Exhibit "B" of this Contract, its legal successors or permitted assigns so long as such entity is a party to this Water Supply Contract, and shall also include any purchaser of treated water from the Authority which becomes a Participating Customer pursuant to the terms of Section 3.4.

"Project" shall mean any real or personal properties or facilities used by the Authority for the treatment, conveyance, storage or distribution of raw or treated water acquired or purchased by the Authority which constitutes a part of the System, and shall include any related real or personal property or facilities or any interest therein, and any related environmental facilities or facilities for conservation, safety and administration reasonably necessary for the operation of the System.

"Prudent Utility Practice" shall mean any of the practices, methods and acts engaged in or approved by a significant portion of the water utility industry during the relevant time period, or any of the practices, methods and acts that, in the exercise of reasonable judgment in light of the facts known at the time the decision was made, could have been expected to accomplish the desired result at lowest reasonable cost consistent with good business practices, reliability, safety, and expedition. Prudent Utility Practice is not intended to be limited to the optimum practice, method, or act, to the exclusion of all others, but rather to include a spectrum of possible practices, methods, or acts generally acceptable in the water utility industry in light of the circumstances.

"Rule" means SEC Rule 15c2-12, as amended from time to time.

"Sale and Offering Documents" means any resolution, indenture, preliminary official statement, or other preliminary offering document for the Bonds.

"SEC" means the United States Securities and Exchange Commission and any successor to its duties.

"SID" means any entity designated by the State or an authorized department, officer, or agency thereof as, and determined by the SEC or its staff to be, a state information depository within the meaning of the Rule from time to time.

"Special Project Facilities" is defined in Section 8.4 of this Contract.

"State" shall mean the State of Texas.

"System" shall mean the Initial Project, any additional Projects, and all other properties and assets, real, personal, tangible and intangible, of the Authority, now or hereafter existing and used to supply water, or any other utility service that the Authority may lawfully provide, to a Participating Customer hereunder and shall include on site general plant and administrative facilities of the Authority and all interest of the Authority in the water treatment, storage, conveyance and distribution facilities and administrative facilities of the Authority, together with all additions, betterments, extensions and improvements thereof hereafter made, together with all lands, easements and rights-of-way of the Authority and all other works, property or structures of the Authority and contract rights, water rights permits and other tangible and intangible assets of the Authority through which water is diverted from the Authority's water supply system or any other supplier of raw water, raw water storage capacity, or raw water pumping and conveyancing.

"System Capacity" shall mean the actual total capacity as reasonably determined and verified by the Authority from time to time of the System to produce and deliver treated water, as provided in Section 3.11.

"System Costs" shall mean the Operating Costs plus the Capital Costs of the System.

"Term" is defined in Section 7.1 of this Contract.

"Water Supply Contracts" shall mean this Contract and the contracts with any other Participating Customers and the Authority, in substantially the same form as this Contract, as amended from time to time; provided, however, that if a Participating Customer is added that was not a Participating Customer on the Effective Date, the Authority reserves the right to charge this new Participating Customer greater (but in no event less than) Capital Costs and/or Operating Costs, or a greater percentage thereof allocated to such new Participating Customer as recognized by the provisions of Section 3.4(b) and Section 3.5(g) hereof. Otherwise, any such contract between the new Participating Customer and the Authority shall be substantially in the form as this Contract.

ARTICLE II
INITIAL FINANCING, ACQUISITION OF PROPERTY
AND CONSTRUCTION OF PROJECTS

Section 2.1. Financing and Construction of Initial Project.

(a) The Authority shall plan the Initial Project and shall prepare an estimate of the costs of the Initial Project. The costs of the Initial Project shall include all construction costs as such term is generally understood in standard accounting practice as applied to utility systems of this nature, and without limiting the generality of the foregoing, shall include purchase of equipment, initial supplies, property, rights in property, capitalized interest as permitted by the laws of the State, costs of land, easements and rights-of-way, including damages to land and property, engineering, financing, financial consultants, administrative, auditing and legal expenses incurred in connection with the acquisition and construction of the Initial Project, plus any and all equipment required for the operation and maintenance thereof and shall also include fiscal, legal and other expenses incurred by the Authority in issuing the Initial Project Bonds and shall provide for a contingency of ten percent (10%). The Authority shall direct its Consulting Engineers to prepare plans and specifications, including estimates of the cost of treated water to the Participating Customer, and direct its Consulting Engineers and attorneys to prepare the contract documents for construction of the Initial Project. The Participating Customer shall be provided preliminary plans and specifications for review and comment as design of the Initial Project progresses. The Participating Customer agrees to supply the Authority's Consulting Engineers with any information necessary to design the facilities which will deliver water to the Participating Customer and to promptly review and comment on the plan and specifications.

(b) Upon finalization of the plans, specifications and contract documents relating to the Initial Project, the Authority shall submit such plans, specifications and contract documents to the Participating Customer for review and comment. The Participating Customer shall provide any comments or requested changes to such plans, specifications and contract documents within 30 days of receipt of such final plans and to consider their approval as soon as practical, subject to satisfactory resolution of any comments or requested changes. The approval of the plans and specifications for the Initial Project shall be at the sole discretion of the Authority. The Authority shall obtain competitive bids in conformity with applicable law for the construction thereof and determine if sufficient funds are available to finance such construction, and the Authority shall use its best efforts to issue the Initial Project Bonds in amounts which the Authority estimates to be sufficient to pay for the costs of the Initial Project. Not later than 15 days prior to the issuance of the Initial Project Bonds, the Authority shall furnish the form of bond resolutions or indenture of trust authorizing issuance of the Initial Project Bonds to the Participating Customer for review and comment. If the Authority determines that sufficient funds are available, and the Authority is satisfied with the bids received, the Authority shall award such contracts to qualified, bondable contractors. The Authority shall then initiate construction as provided in the plans, specifications and contract documents, subject to any written change orders issued during construction.

(c) The Authority agrees to use reasonable diligence in constructing and completing the Initial Project pursuant to the provisions hereof and to commence operation of the Initial Project within eighteen (18) months after the date of issuance of the Initial Project Bonds. The

Authority shall supply the Participating Customer with monthly reports as to the progress and costs of construction of the Initial Project and shall include a description of any change orders issued during construction.

Section 2.2. Acquisition of Real Estate and Easements. The Authority shall determine the location of the System's facilities and shall acquire the real estate and the sites therefor. The water treatment facility shall be located in the City of Brownsville, Texas and to the extent permitted by law in the Brownsville Public Utilities Board's certificated electric service area. The Authority and the Participating Customer shall determine the necessary rights-of-way which must be acquired and proceed to acquire the necessary real estate, permits or easements. The Participating Customer agrees to grant at no cost to the Authority rights to use the Participating Customer's public easements and rights of ways, and public and private utility easements as necessary for the construction, operation and maintenance of the System's facilities in accordance with the Participating Customer's ordinances and codes, but only to the extent of the Participating Customer's rights.

Section 2.3. Allocation of Responsibility for Bonds. After bids are received and prior to the issuance of the Initial Project Bonds to finance the Initial Project, the Authority shall submit to the Participating Customer for review and comment the bond resolution or indenture for the issuance of Bonds and its estimated responsibility for all Capital Costs associated with such series of Bonds. The Authority expects to issue contract revenue bonds which are payable solely from the Capital Costs charges payable by the Participating Customer pursuant to this Contract (together with income from investments in reserve funds, if any, created under the bond resolution or bond indenture authorizing the issuance of the Bonds) and Capital Cost charges payable by the other Participating Customers pursuant to agreements with the Authority, the terms of which, except as provided herein, do not materially differ from this Contract. The Authority shall not issue Bonds for the Initial Project secured by payments from the Contract without the prior approval of Bonds and the bond resolution or indenture by the governing body of the Participating Customer.

Section 2.4. Design Capacity. The Initial Project shall be designed so that the water treatment plant will produce treated water complying with the quality standards for potable water as provided in this Contract at a minimum rated capacity of 7.5 MGD, on a consistent basis throughout a calendar year in compliance with regulatory requirements. After the Commencement Date of the Initial Project, the Authority shall make appropriate tests to determine the actual rated capacity of the water treatment plant as provided in Section 3.11.

Section 2.5. Ownership. It is expressly agreed and understood that as between the parties hereto, the Authority shall be the owner of the System. The Authority will not sell the System or any substantial part thereof without the prior written approval of the Participating Customer.

Section 2.6. Management and Operation.

(a) During the period that the Public Utilities Board of the City of Brownsville, Texas ("BPUB") is a Participating Customer, BPUB's General Manager and CEO shall serve as the General Manager of the Authority. The General Manager shall perform or cause to be performed

all administrative functions of the Authority, including, but not limited to, accounting and auditing services, management of finances, System operations, personnel, equipment, property and any other assets of the Authority. BPUB's General Manager, in coordination with the Chairman of the Board of Directors, shall schedule meetings of the Board of Directors, be responsible for all required notices of meetings, prepare agendas for meetings and shall serve as custodian of the official records of the Authority. BPUB's General Manager shall take all reasonable actions to maintain compliance by the Authority with all applicable laws.

(b) BPUB, during the period it is a Participating Customer, shall act as the System operator of the Authority.

ARTICLE III PURCHASE AND SALE OF WATER

Section 3.1. Allocated Portion. Subject to the other provisions of this Contract, the Authority agrees to sell and deliver to the Participating Customer, and the Participating Customer agrees to take and pay for all of its Allocated Portion of the System Capacity. Based upon the design of the System Capacity, Participating Customer shall be entitled to receive treated water at a daily rate of delivery equivalent to its Allocated Portion during each day of the year (subject to planned outages for maintenance and repairs or Force Majeure). The Participating Customer's initial "Allocated Portion of System Capacity" (averaged over each calendar year) is designated on Exhibit "B". Each Participating Customer shall have the right to receive its Allocated Portion of System Capacity during the term of this Contract, except as otherwise permitted herein.

Section 3.2. Increases or Decreases in System Capacity. If the System Capacity is increased or decreased at any time pursuant to Section 3.12 that is not due to construction of an additional Project or a Special Project Facility, each Participating Customer shall be entitled to its Allocated Portion of the increased or decreased System Capacity, except to the extent another mutually acceptable arrangement is agreed to by the Participating Customers.

Section 3.3. Additional Projects or New Projects. Each Participating Customer will have the first right to participate in future phases of the Project based upon the initial "Allocated Portion of System Capacity" designated on Exhibit "B". Any additional System Capacity due to the construction of an additional Project shall not be offered to a party that is not a Participating Customer as of the Effective Date until all such Participating Customers have been offered such additional System Capacity.

Section 3.4. Reallocation of Allocated Portion. The Participating Customer's Allocated Portion may be decreased at the request of the Participating Customer at any time by an amount equal to the percentage of the Participating Customer's Allocated Portion which any other financially responsible Participating Customer is willing to contract for from the Authority under the terms of their Water Supply Contract for the Term thereof. The Participating Customer shall notify the Authority in writing of the amount of its Allocated Portion which it wishes to transfer to another Participating Customer. Within seven (7) days of receipt of such notice, the Authority shall notify all of the other Participating Customers of the availability of such Allocated Portion. Each of the Participating Customers shall have the option to assume any portion of its pro rata share of the available Allocated Portion, each Participating Customer's pro

rata share of the available Allocated Portion being in the same proportion the Participating Customer's Allocated Portion bears to the sum of the Allocated Portions of all Participating Customers exercising their options. Such options must be exercised, if at all, within sixty (60) days after receipt by the Participating Customers of notice of the availability of the water. Upon execution of an assignment and assumption agreement concerning the Allocated Portion made available, the assigning Participating Customer shall not, however, be relieved of its primary obligations to make the payments set forth in this Article III. Each decrease in Allocated Portion shall be effective on the date the Authority approves the written assignment and assumption agreement or on any later date mutually agreed upon by the parties, and Exhibit "B" of this Contract shall be supplemented by the Authority to reflect such changes in Allocated Portion. If none of the Participating Customers elects to contract for such Allocated Portion, the Allocated Portion of System Capacity shall remain part of the offering Participating Customer's Allocated Portion of System Capacity and such Participating Customer shall remain responsible therefor.

Section 3.5. Price of Water.

(a) The parties recognize that because the Capital Costs related to its Bonds issued to provide facilities with which to serve the Participating Customers are not presently known, and because the Operating Costs of the System will vary from time to time, it is neither practical nor possible to fix a schedule of specific rates in this Contract which will control the price the Participating Customer will pay to the Authority for water delivered throughout the Term of this Contract. The parties further recognize, however, that the Authority is not organized for profit and that its rates for water should at all times be the lowest rates which are consistent with Prudent Utility Practice on the part of the Authority and with the commitments which the Authority makes to its bondholders and in order to provide funds with which to operate and maintain the System.

(b) The Authority shall establish classes of customers to which it sells treated water from the System. The Participating Customers shall constitute one class of customers of the Authority. From time to time, the Authority may establish other classes of customers which may consist of one or more customers. The Authority recognizes, and agrees to abide by its obligation to serve all customers of the same class without discrimination as to rates, priority, terms, conditions or type of service and agrees to establish rates in conformity with all applicable laws, rules and regulations of the State. The Participating Customer understands and agrees, however, that the Capital Costs of each Participating Customer may not be the same. The Authority shall never sell water to any other class of customers at a rate less than the sum of (i) the rate for Operating Costs paid by the Participating Customers, plus (ii) an amount determined by the Authority to be a fair allocation of the Capital Costs based upon the capacity of the System utilized by the customer and the Authority's then outstanding debt for Capital Costs. Any revenues received by the Authority from the sale of water to a class of customers that are not Participating Customers shall be utilized by the Authority to pay System Costs.

(c) The water rates paid by the Participating Customers in the aggregate are intended to be sufficient for the Authority to recover the System Costs. The water rates shall include (i) Capital Costs and (ii) Operating Costs.

(d) The amount of the annual Capital Costs to be paid by the Participating Customer shall be determined by the Authority for each Fiscal Year and shall represent the Participating Customer's share of all Capital Costs based on Bonds issued to fund the Participating Customer's share of the System (to the extent that Bonds have been issued by the Authority which are payable from Capital Costs payable by the Participating Customer) and with respect to Capital Costs, if any, which are not required by such Bonds then based upon the Participating Customer's Capital Cost Responsibility. For the first two years after the issuance of the Initial Project Bonds and for so long thereafter as is determined reasonable by the Authority, the annual Capital Costs of each Participating Customer shall be due and payable in a single payment on or before December 1 of such year or at such other time as shall be determined by the Authority. Thereafter, approximately one-twelfth (1/12) of such amount shall be payable on a monthly basis, the exact amount to be determined from time to time by the Authority. Notwithstanding the aforesaid, however, the Participating Customers' obligations shall be reduced by an allocated amount of the Capital Costs which any other customer of the System contracts to pay for under their contract with the Authority to the extent that the Authority actually receives payment for any such other customer.

(e) The amount of the Operating Costs to be paid by the Participating Customer shall be established on a monthly basis by the Annual System Budget as described in Sections 4.2 and 4.3 and adjusted from time to time as the Authority deems necessary to cover its Operating Costs. The Annual System Budget, as amended, shall provide for payment by the Participating Customer on a monthly basis which corresponds to the Authority's Operating Costs, but the payments shall be trued up at the end of each Fiscal Year so that each Participating Customer pays the same rate for Operating Costs per 1,000 gallons of water delivered to the Participating Customers.

(f) If the Authority finances Special Project Facilities for any Participating Customer, such Participating Customer shall agree to pay the costs of financing, operating and maintaining such Special Project Facilities as an additional charge hereunder on such terms as the Participating Customer and the Authority shall agree.

(g) The rate for water charged to any customer(s) which are not Participating Customers shall be sufficient for the Authority to recover at least: (1) the costs of financing, maintaining and operating any Special Project Facilities which such customer(s) contract to pay for; (2) the rate per 1,000 gallons of water actually delivered to such customer(s) established by the Authority on the basis of the Annual System Budget and charged all other customers (including the Participating Customers); (3) any part of the Capital Costs of the System based on such customer's Capital Cost Responsibility for the System not financed with bonds issued to finance the Special Project Facilities; and (4) any additional surcharges which may be established by the Authority.

Section 3.6. Payments by Participating Customer Unconditional. The Participating Customer and the Authority recognize that the Bonds will be payable from, and secured by, a pledge of the sums of money to be received by the Authority under this Contract and the other Water Supply Contracts and that in order to make the Bonds marketable at the lowest available interest rate, it is to the mutual advantage of the Participating Customer and the Authority that the Participating Customer's obligation to make the payments required hereunder be

unconditional. All sums payable hereunder to the Authority shall, so long as any part of the Bonds are outstanding and unpaid, be paid by the Participating Customer without set-off, counter-claim, abatement, suspension or diminution except as otherwise expressly provided herein. So long as any part of the Bonds are outstanding and unpaid, this Contract shall not terminate, nor shall the Participating Customer have any right to terminate this Contract nor be entitled to the abatement of any payment or any reduction thereof nor shall the obligations hereunder of the Participating Customer be otherwise affected for any reason, it being the intention of the parties that so long as any part of the Bonds are outstanding and unpaid, all sums required to be paid by the Participating Customer to the Authority shall continue to be payable in all events and the obligations of the Participating Customer hereunder shall continue unaffected, unless the requirement to pay the same shall be reduced or terminated pursuant to an express provision of this Contract. The amounts owed by the Participating Customer under this Contract shall be payable by the Participating Customer, notwithstanding the suspension, interruption, temporary termination or unavailability of water from the System, in whole or in part, for any reason whatsoever, and shall not be subject to any reduction, whether by offset or otherwise.

Section 3.7. Source of Payments. Payments required to be made by the Participating Customer to the Authority under this Contract shall be payable from the revenues and income received by the Participating Customer from the ownership and operation of the Participant's System (or its water system as a portion of its combined utility system) or any other lawfully available funds or revenues of the Participating Customer. Subject to the provisions of Section 3.8 hereof, the Authority shall never have the right to demand payment by the Participating Customer of any obligations assumed by or imposed upon it under or by virtue of this Contract from any funds raised or to be raised by ad valorem taxation, and the Participating Customer's obligations under this Contract shall never be construed to be a debt of the Participating Customer of such kind as to require it under the Constitution and laws of the State to levy and collect an ad valorem tax to discharge such obligation. Nothing in this Section 3.7, however, shall be construed as preventing the Participating Customer, in its sole discretion, from making any such payment from sources other than revenues and income of the Participant's System. Pursuant to the provisions of Section 5(b) of the Interlocal Cooperation Act, such payments made hereunder shall be an operating expense of the Participant's System.

Alternatively, any of the Participating Customers, to the extent authorized by applicable law, may call an election in accordance with Section 49.108, Texas Water Code, as amended, for the approval of this Contract and the authorization to levy, assess and collect ad valorem taxes on all taxable property within the boundaries of the Participating Customer, without limit as to rate or amount, sufficient to make timely payment of all charges under this Contract to the Authority. Subject to the passage of the election, the Participating Customer agrees to levy and shall annually assess and collect a continuing, direct ad valorem tax on all taxable property within the boundaries of the Participating Customer to make timely payments of all charges required under this Contract to the Authority, without limitations as to rate or amount, sufficient to pay the Participating Customer's Capital Costs owed to the Authority to pay debt service requirements on the Authority's Bonds issued pursuant to this Contract.

Section 3.8. Covenant to Maintain Sufficient Income. The Participating Customer agrees to own (subject to the Participating Customer's right to sell a portion of the Participant's System upon compliance with applicable law) the Participant's System throughout the Term of

this Contract, and agrees to fix and maintain such rates and collect such charges for the facilities and services provided by the Participant's System as will be adequate to permit the Participating Customer to make prompt payment of its obligations hereunder, and to make prompt payment of the interest on and principal of the bonds or other obligations of the Participating Customer payable, in whole or in part, from the revenues of the Participant's System.

Section 3.9. Issuance of Other Indebtedness by Participating Customer. The Participating Customer covenants and agrees that, from and after the Effective Date, it shall not issue bonds, notes or other evidences of indebtedness or incur lease obligations which, under generally accepted accounting principles, would appear as a liability on its balance sheet which shall be payable from the revenues derived from the Participant's System on a parity with, or superior to the payment of the operating expenses of the Participant's System without the prior written consent of any insurer or entity providing credit enhancement with respect to the Bonds, if any. Nothing in this Section 3.9 shall preclude the Participating Customer from issuing bonds, notes or other evidences of indebtedness payable from the net revenues of the Participant's System or from revenues derived from taxes, or both. The Participating Customer further agrees to comply with all of the provisions of the resolutions, ordinances or indentures authorizing its other bonds or other obligations which are payable, in whole or in part, from the net revenues of the Participant's System.

Section 3.10. Sale of Water by Participating Customer. The Participating Customer shall have the right to maintain existing contracts or to enter into contracts for the resale of water delivered to the Participating Customer by the Authority. The consideration as between or among the Participating Customer and its customers shall be determined by the contracting parties, but no such contract shall relieve the Participating Customer of its primary obligation to the Authority under the terms of this Contract. Before a Participating Customer may resell to a third party any water that was originally delivered to it by the Authority, the Participating Customer must first offer that water for sale to other Participating Customers. Water sold to more than one Participating Customer will be allocated based on the original Allocated Portion of the System Capacity, except to the extent another mutually acceptable arrangement is agreed to by the Participating Customers.

Section 3.11. Rated Water Treatment Capacity of System. The Authority shall, from time to time, determine if the rated water treatment capacity should be changed (increased or decreased) to reflect the actual capacity of the System to supply treated water complying with water quality standards for potable water as provided in this Contract on a consistent basis if operated throughout the year in accordance with regulatory requirements. Any such determination shall be based upon a written report by the Consulting Engineer. The Authority shall give the Participating Customer prior notice of any test to redetermine the rated water treatment capacity of the System and attain the Participating Customer and its Consulting Engineer or other representations the opportunity to be present during any test period and to review and comment on a draft of the report of the Consulting Engineer. Any change in the rated water treatment capacity shall not affect the obligations of the Participating Customer or its Allocated Portion of the System Capacity.

Section 3.12. Allocated Portion of Participating Customer in Default. In the event of default pursuant to Section 6.1 and Section 6.2 hereof, which is not cured after the expiration of

applicable cure periods, the Allocated Portion of the System Capacity belonging to the defaulting Participating Customer will be available to be acquired by the remaining Participating Customers. The remaining Participating Customers shall have a right to obtain a proportionate share of the defaulting Participating Customer's Allocated Portion of System Capacity. In the event any Participating Customer does not elect to acquire their proportionate share of water made available as a result of the default, the water will be acquired by Brownsville Public Utilities Board. Any water transferred from a defaulting Participating Customer to another Participating Customer will be a permanent increase in the acquiring Participating Customer's Allocated Portion of the System Capacity, and will from the date of acquisition of the water be a proportionate increase in the payment of Capital Costs and Operating Costs.

ARTICLE IV BILLING, PAYMENT AND ACCOUNTS

Section 4.1. Billing. The Authority shall bill the Participating Customer in advance on a monthly basis. Payment shall be due upon receipt of such invoice by the Participating Customer. Payments which are not received within thirty (30) days of the receipt of such invoice shall bear interest at twelve percent (12%) per annum, based upon a 365 or 366 day year.

Section 4.2. Annual System Budget For Authority. The Authority shall prepare, or cause to be prepared, and deliver to the Participating Customer its proposed Annual System Budget at least seventy-five (75) days prior to the beginning of each Fiscal Year. The proposed Annual System Budget shall itemize estimates of all Capital Costs and all Operating Costs and all revenues for the ensuing Fiscal Year. After consultation with and due consideration in good faith of any written comments submitted to the Authority by the Participating Customer within thirty (30) days of receipt of the Annual System Budget concerning specific cost items or revenue items, the Authority shall, not less than thirty (30) days prior to the beginning of such Fiscal Year, adopt an Annual System Budget for such Fiscal Year and shall deliver copies of such Annual System Budget to the Participating Customer. Any objection of a Participating Customer to an Annual System Budget shall be subject to mediation as provided in Section 6.4.

Section 4.3. Amendment to Annual System Budget. If, at any time, or from time to time, after the adoption of an Annual System Budget, the Authority estimates that the Operating Costs or Capital Costs of the System for the Fiscal Year or any part thereof for which such Annual System Budget applies will be substantially greater or less than the Operating Costs or Capital Costs or revenues set forth in the Annual System Budget during the remainder of such Fiscal Year, then the Authority shall prepare and deliver to the Participating Customers an amended Annual System Budget. The amended Annual System Budget shall itemize estimates of all Capital Costs and all Operating Costs and revenues for the remainder of that Fiscal Year. After consultation with and due consideration in good faith of any written comments submitted to the Authority by the Participating Customers within fifteen (15) days of receipt of the amended Annual System Budget concerning specific cost items or revenue items, the Authority shall adopt an amended Annual System Budget for such Fiscal Year and shall deliver copies of such amended Annual System Budget to the Participating Customer. The amended Annual System Budget shall then supersede the Annual System Budget or amended Annual System Budget previously provided. Any objection of a Participating Customer to an amendment to an Annual System Budget shall be subject to mediation as provided in Section 6.4, so long as such

amendment would increase or decrease the Annual System Budget by an amount greater than twenty percent (20%).

Section 4.4. Payment Based upon System Budget. The Participating Customer hereby agrees to pay the rates set by the Authority for water on the basis of the Annual System Budget, as amended from time to time, without objection, dispute or contest, unless the Participating Customer initiates mediation and thereafter appeals to the Texas Commission on Environmental Quality, in which case the Participating Customer shall pay such rates, subject to rebate, until a final result of mediation or a final decision of any such appeal. Except for mediation, appeal to Texas Commission on Environmental Quality shall be the sole remedy in connection with any dispute with respect to rates.

Section 4.5. Regulatory Jurisdiction. Nothing herein shall be construed as depriving the State of its power to regulate and control fees and charges to be collected for the use of water, provided that the parties do hereby pledge to and agree with the purchasers and successive holders of the Bonds that they will not seek to limit or alter the ability of the Authority to establish and collect such fees and charges as will produce revenues sufficient (a) to pay all expenses necessary to the operation and maintenance of the System; (b) to pay the interest on and the principal of all Bonds issued when and as the same shall become due and payable; (c) to pay all sinking fund and/or reserve fund payments agreed to be made in respect of any such Bonds, when and as the same shall become due and payable; and (d) to fulfill the terms of any agreements made with the holders of such bonds and/or with any person on their behalf, solely from the revenues of the System. Any dispute between the parties to this Contract regarding the fees and charges to be collected for the use of water shall be subject to the mediation provisions of Section 6.4 of this Contract.

Section 4.6. Accounts and Annual Audit. The Authority will keep accurate records and accounts of the System as a separate utility system and of the transactions relating to the System as well as of the operations of the Authority in accordance with generally accepted accounting principles for governmental entities of the State. After the close of each Fiscal Year, the Authority shall cause such records and accounts and all transactions of the Authority relating to the System with respect to such Fiscal Year, including specifically a comparison of the Annual System Budget or amended Annual System Budget with the actual costs incurred during that Fiscal Year of the specific items included as Capital Costs and Operating Costs, to be subject to an annual audit by the Authority's Accountant. Within one hundred twenty (120) days of the close of each Fiscal Year, a copy of such annual audit, including all written comments and recommendations of such Accountant, shall be sent by the Authority to the Participating Customer. If the annual audit indicates that the water rates paid by the Participating Customers during the preceding Fiscal Year exceeded or were less than the amount which the Authority reasonably and prudently needed to recover the Operating Costs and Capital Costs of the System, then the Authority shall appropriately adjust the water rates for the Participating Customers.

The Authority shall keep books, records, and all other documents relating to the costs of operating the System for at least five (5) years, and said books, records, and other documents shall be available for inspection by the Participating Customer at reasonable times, places and upon reasonable notice.

The Participating Customer shall have the right to perform an independent audit of the records and accounts of the System at the cost and expense of the Participating Customer. The Authority covenants and agrees to make records and other data available during normal business hours and to provide reasonable assistance to the Participating Customer performing an independent audit.

Section 4.7. Participating Customer's Accounts. The Participating Customer shall keep accurate records and accounts for the Participant's System, and such records and accounts shall be audited annually by an independent certified public accountant, and a copy of such annual audit, pertaining to the Participant's System, shall be furnished to the Authority not later than one hundred thirty-five (135) days after the close of the Participating Customer's fiscal year.

If the Participating Customer presently (or hereafter) maintains, for accounting purposes, a combined utility fund and combined operating and maintenance expenses, the preceding paragraph shall not be construed as requiring the Participating Customer to maintain a fund for its water system separate and apart from the Participating Customer's combined utility fund.

ARTICLE V OPERATION AND MAINTENANCE

Section 5.1. Point of Delivery and Title. The Delivery Point of water by the Authority to the Participating Customer shall be the same point or points designated on Exhibit "A" hereto, unless and until the Authority and the Participating Customer, by mutual written agreement, designate a substitute or additional Delivery Points. Title to the water shall pass to the Participating Customer when it passes through the meter at or near the Delivery Point. The Participating Customer will be responsible for maintenance of the line between the meter and the Participating Customer's ground storage tank(s) or its utility system transmission line, as appropriate.

Section 5.2. Delivery and Terminal Storage. Water will be delivered to the Participating Customer through an airgap connection at an Average Daily Rate and Acceptable Pressure to provide the Participating Customer's Allocated Portion.

Section 5.3. Measuring and Control Equipment. The Authority shall furnish, install, operate and maintain at its own expense at the Delivery Point the necessary equipment and devices of standard type for properly measuring and controlling the quantity of water delivered under this Contract. Such meter or meters or other equipment so installed shall remain the property of the Authority. Approval and installation of the equipment shall be coordinated with the Participating Customer prior to installation. The Participating Customer shall have access to such metering equipment at all reasonable times, but the reading, calibration and adjustment thereof shall be done only by the employees or agents of the Authority. For the purpose of this Contract, the original record or reading of the meter or meters shall be in a journal or other record book of the Authority in its office in which the records of the employees or agents of the Authority who take the readings are or may be transcribed. Upon written request of the Participating Customer, the Authority will give the Participating Customer a copy of such journal or record book, or permit the Participating Customer to have access to the same in the office of the Authority during normal business hours.

Not more often than once in each calendar quarter, on a date as near to the end of such calendar month as practicable, the Authority shall calibrate its meters if requested in writing by the Participating Customer to do so, in the presence of a representative of the Participating Customer, and the parties shall jointly observe any adjustments which are made to the meters in case any adjustment shall be necessary, and if the check meters hereinafter provided for shall have been installed, the same shall also be calibrated by the Participating Customer in the presence of a representative of the Authority and the parties shall jointly observe any adjustment in case any adjustment is necessary. If the Participating Customer shall in writing request the Authority to calibrate its meters, the Authority shall give the Participating Customer at least three Business Days prior notice of the time when any such calibration is to be made during normal business hours. If the representative of the Participating Customer is not present at the time set, the Authority may proceed with calibration and adjustment in the absence of any representative of the Participating Customer.

The Participating Customer shall, at its option and own expense, install and operate a check meter to check each meter installed by the Authority, but the measurement of water for the purposes of this Contract shall be solely by the Authority's meters, except in the cases hereinafter specifically provided to the contrary. All such check meters shall be of standard make and shall be subject at all reasonable times to inspection and examination by any employee or agent of the Authority but the reading, calibration and adjustment thereof shall be made only by the Participating Customer. The check meter shall be subject to the operating procedures established by the Authority.

If upon any test, the percentage of inaccuracy of any metering equipment is found to be in excess of two percent (2%), registration thereof shall be corrected for a period extending back to the time when such inaccuracy began, if such time is ascertainable, and if such time is not ascertainable, then for a period extending back one-half (1/2) of the time elapsed since the last date of calibration, but in no event further back than a period of six (6) months. If for any reason any meters are out of service or out of repair so that the amount of water delivered cannot be ascertained or computed from the reading thereof, the water delivered through the period such meters are out of service or out of repair shall be estimated and agreed upon by the parties hereto upon the basis of the best data available. For such purpose, the best data available shall be deemed to be the registration of any check meter or meters if the same have been installed and are accurately registering. Otherwise, the amount of water delivered during such period will be estimated in the following sequence:

- (a) by reading the Participating Customer's check meter; or
- (b) correcting the error if the percentage of the error is ascertainable by calibration tests or mathematical calculation; or
- (c) by using the Participating Customer's own records of resale of water to all customers of its water system.

Section 5.4. Unit of Measurement. The unit of measurement for water delivered hereunder shall be 1,000 gallons of water, U. S. Standard Liquid Measure.

Section 5.5. Quality. The Authority agrees to deliver to the Participating Customer the Participating Customer's requirements for water of sufficient quality to conform to the standards of the Texas Commission on Environmental Quality for potable water.

Section 5.6. Data. To permit the Authority to accumulate statistical data which would enable it to render better service and facilitate plans for betterment and future expansion of the System, the Participating Customer agrees to furnish to the Authority, prior to the Commencement Date and annually thereafter, such information regarding the Authority may reasonably from time to time request. In addition, the Participating Customer shall provide the Authority on a monthly basis with a copy of its reports to the Texas Commission on Environmental Quality regarding its water usage. The Authority shall use the aforesaid information to plan for the Participating Customer's future needs for treated water and shall conduct or commission such studies as the Authority deems necessary in order to provide for expansions of the System Capacity. Any such expansions shall be conducted pursuant to the terms of this Contract.

Section 5.7. Standard of Operation and Contracts with Third Parties. The Authority may from time to time establish standards and rules and regulations for such operation which are not inconsistent with providing water service to Parties that are not Participating Customers. The Authority reserves the right to contract with other parties to render services for the operation, maintenance or supply of the System.

Section 5.8. Interruptions in Service. The Authority shall deliver to the Participating Customer a constant and uninterrupted supply of water in accordance with the provisions of this Contract. The Authority may schedule a temporary interruption and reduction of deliveries of water to the Participating Customer if the Authority determines that such interruption or reduction is necessary in case of emergencies or to install equipment, make repairs, replacements, or inspections, or perform any other maintenance work on its System. After informing the Participating Customer regarding any such planned interruption or reduction, giving the reason therefor, and stating the probable duration thereof, the Authority will attempt to schedule such interruption or reduction at a time which will cause the least interference with the operations of the Participating Customers. The Authority shall have no liability to the Participating Customer for any damages caused by any interruption in service or any failure (partial or total) to deliver water to the Participating Customer, other than to the extent that such interruption in service results from the gross negligence or willful misconduct of the Authority. If for any reason beyond the control of the Authority it is unable to deliver water at the System Capacity to all of the Participating Customers, the Authority shall have the right to allocate the water available for delivery to the Participating Customer; provided however, that any allocation shall be reasonably proportionate and shall conform to the priorities of use established by law.

Section 5.9. Water Conservation Plans. The Authority and the Participating Customer agree to take all actions necessary for the adoption of water conservation and drought contingency plans required by applicable law, including, 30 Texas Administrative Code § 288.1 et. seq., and as required by the Texas Water Development Board. The Participating Customer and the Authority covenant to amend such plans from time to time to comply with applicable laws and to comply with such plans during the term of the Contract.

Section 5.10. Monthly Operations Report. The Authority covenants and agrees to provide the Participating Customer with a monthly operations report. The monthly operations report shall contain all information required by the rules and regulations established by the Authority. The monthly operations reports shall at a minimum include unaudited financial statements, the quantity of water delivered from the System, the current System Capacity and any material maintenance or repairs performed or required.

ARTICLE VI DEFAULT AND REMEDIES

Section 6.1. Default. The following shall be considered a default under this Contract:

(a) the failure of the Participating Customer to make any monetary payment when due under this Contract and such failure is continuing for five (5) Business Days; or

(b) the failure of either party after mediation pursuant to Section 6.4 to perform and observe in a timely manner any non-monetary obligations or covenants contained in this Contract and such failure is not cured within fifteen (15) days after notice, specifying such default, is given to the non-performing party by the other party; provided, however, that if the nonperformance cannot reasonably be cured within fifteen (15) days, then no default shall occur if, and as long as, the party has initiated all remedial action reasonably possible within the fifteen (15) day period and thereafter continues diligently to remedy the failure.

Section 6.2. Remedies Upon Default.

(a) It is not intended hereby to specify (and this Contract shall not be considered as specifying) an exclusive remedy for any default, but all such other remedies (other than termination subject to the provisions of Section 6.2(b)) existing at law or in equity may be availed of by either party and shall be cumulative after mediation pursuant to Section 6.4. Recognizing, however, that the Authority's undertaking to provide and maintain services as provided herein is an obligation, failure in the performance of which cannot be adequately compensated in money damages alone, the Authority agrees, in the event of any default on its part, that the Participating Customer shall have available to it the equitable remedy of specific performance in addition to any other legal or equitable remedy (other than termination) which may also be available to the Participating Customer.

(b) If a monetary default shall occur and be continuing, the Authority shall have the right to cease delivery of water under this Contract by giving to the Participating Customer thirty (30) days' advance written notice of the effective date of such cessation. Such cessation, however, shall not be effective if prior to the effective date of cessation the Participating Customer shall have fully paid such bill and the interest accrued thereon. In addition, the Authority shall have the right to terminate all of the Participating Customer's other rights, including the Participating Customer's right to receive delivery of water hereunder, but not the Participating Customer's monetary and non-monetary obligations, under this Contract. No termination of rights pursuant to this Section 6.2(b) or reassignment of any rights of the defaulting Participating Customer, including all or part of its Allocated Portion, shall have the

effect of relieving the defaulting Participating Customer of any liability which it would otherwise have had if no such termination or reassignment had occurred, except to the extent that such liability is offset from time to time by payments actually made to the Authority by the Participating Customer(s) acquiring terminated rights of the defaulting Participating Customer.

(c) The Authority or any Participating Customer, jointly or severally, may commence suits, actions or proceedings, at law or in equity, including suits for specific performance as may be necessary or appropriate to enforce the obligations of any defaulting Participating Customers under their Water Supply Contracts.

Section 6.3. Limitation on Damages.

(a) AS BETWEEN THE PARTIES, EACH PARTY'S LIABILITY SHALL BE LIMITED TO DIRECT ACTUAL DAMAGES (INCLUDING INTEREST AS PERMITTED BY APPLICABLE LAW) ONLY, AND, NO PARTY SHALL BE LIABLE FOR CONSEQUENTIAL, INCIDENTAL, PUNITIVE, MULTIPLE, EXEMPLARY OR INDIRECT DAMAGES, PENALTIES, LOST PROFITS OR OTHER BUSINESS INTERRUPTION DAMAGES, BY STATUTE, IN TORT OR IN CONTRACT UNDER ANY INDEMNITY PROVISION OR OTHERWISE. IT IS THE INTENT OF THE PARTIES THAT THE LIMITATIONS HEREIN IMPOSED ON REMEDIES AND THE MEASURE OF DAMAGES BE WITHOUT REGARD TO THE CAUSE OR CAUSES RELATED THERETO, INCLUDING THE GROSS NEGLIGENCE OF ANY PARTY, WHETHER SUCH GROSS NEGLIGENCE BE SOLE, JOINT OR CONCURRENT, OR ACTIVE OR PASSIVE. FURTHER, THE PARTIES AGREE THAT NEITHER PARTY SHALL BE LIABLE FOR DIRECT ACTUAL DAMAGES EXCEPT IN THE EVENT THAT SUCH DIRECT ACTUAL DAMAGES ARE THE RESULT OF GROSS NEGLIGENCE OR WILLFUL MISCONDUCT.

(b) Each Party agrees that it has a duty to mitigate damages and covenants that it will use commercially reasonable efforts to minimize any damages it may incur as a result of the other Party's performance or nonperformance of this Contract.

Section 6.4. Mediation. If a dispute arises out of or relates to this Contract or the breach thereof, the parties shall first in good faith seek to resolve the dispute through negotiation. If such dispute cannot be settled through negotiation, the parties agree to try in good faith to settle the dispute by mediation under the Commercial Mediation Rules of the American Arbitration Association, before resorting to arbitration, litigation, or some other dispute resolution procedure; provided that a party may not invoke mediation unless it has provided the other with written notice of the dispute and has attempted in good faith to resolve such dispute through negotiation. Notwithstanding the foregoing, any party may seek immediate equitable relief, without attempting to settle a dispute through mediation, in any case where such party is entitled to equitable relief by the terms of this Contract or otherwise.

Section 6.5. Standard of Care. The standard of care applicable to each of the parties in connection with performance of all obligations under this Contract and in connection with the operation, maintenance and management of the System by the Authority shall be Prudent Utility Practice, provided however, that except for the obligation of the Participating Customer to pay its share of System Costs, neither party shall be liable to the other for monetary

damages unless the failure to act in accordance with Prudent Utility Practice arises from gross negligence or willful misconduct on the part of a party.

Section 6.6. No Additional Waiver Implied. No waiver or waivers of any breach or default (or any breaches or defaults) by either party hereto of any term, covenant, condition, or liability hereunder, or of performance by the other party of any duty or obligation hereunder, shall be deemed or construed to be a waiver of subsequent breaches or defaults of any kind, under any circumstance, but any breach or default shall be deemed to be conclusively waived upon the expiration of 730 days after it occurs.

Section 6.7. Force Majeure. If Force Majeure prevents either party hereto from performing any of its obligations under this Contract (except the unconditional obligation of the Participating Customer to make the payments required in Article III), in whole or in part, then the obligations of such party, to the extent affected by such Force Majeure, shall be suspended during the continuance of any inability so caused, so long as such party is exercising reasonable diligence to resume performance at the earliest practicable time. As soon as reasonably possible after the occurrence of the Force Majeure relied upon, the party whose contractual obligations are affected thereby shall give notice and full particulars of such Force Majeure to the other party. The term "Force Majeure," as used herein, shall include, without limitation of the generality thereof, acts of God, strikes, lockouts, or other industrial disturbances, acts of the public enemy, orders of any kind of the Government of the United States, of the State, of any civil or military authority, insurrections, riots, epidemics, landslides, drought, lightning, earthquakes, fires, hurricanes, storms, floods, washouts, droughts, arrests, restraint of government and people, civil disturbances, explosions, breakage or accidents to machinery, pipelines or canals, or of the Authority to supply water received through third parties and any other incapacities of either party, whether similar to those enumerated or otherwise, which are not within the control of the party claiming such inability, and which such party could not have avoided by the exercise of reasonable diligence and care. It is understood and agreed that the settlement of strikes and lockouts shall be entirely within the discretion of the party having the difficulty and that the above requirement that any Force Majeure shall be remedied with all reasonable dispatch shall not require the settlement of strikes and lockouts by acceding to the demands of the opposing party or parties when such settlement is unfavorable to it in the judgment of the party having the difficulty.

ARTICLE VII TERM

Section 7.1. Term. This Contract shall remain in effect from the Effective Date for a term of thirty (30) years and thereafter until payment in full of the principal, premium, if any, and interest on all Bonds issued during the initial term and all related fees to be paid pursuant to any bond resolution or indenture securing such Bonds.

Section 7.2. Renewal of Contract. Upon the expiration of the Term of this Contract, the Authority agrees to negotiate with the Participating Customer to continue to provide water (to the extent then permitted by law) and in the negotiation of such contract to recognize the Participating Customer's contribution to the financing of the System and the Participating Customer's equitable right to continue to receive water from the Project.

Section 7.3. Termination after Prepayment. If at any time after the Effective Date of this Contract, all of the principal, premium, if any, and interest due to stated maturity (or earlier optional redemption date) of the Bonds is paid in full, the Participating Customer shall have no further obligation to make any payments to the Authority defined herein as Capital Costs which are directly related to such Bonds, but all other rights and obligations of the parties under this Contract, including the Participating Customer's right to receive water and obligation to pay all other Operating Costs, shall continue. After such payment in full of all of the Bonds, and upon twelve (12) months prior written notice to the Authority, the Participating Customer, if not then in default, shall have the right to terminate this Contract.

ARTICLE VIII ADDITIONAL FINANCING PROVISIONS

Section 8.1. Bonds Issued to Complete a Project. If, in addition to the amount of the Initial Project Bonds, or any other series of Bonds issued to finance an additional Project, the Board of Directors of the Authority determines, based upon the recommendation of its Consulting Engineers, that additional funds in an amount not to exceed ten percent (10%) of the original estimated cost of such project (including provision for contingencies) are required to complete the Project in accordance with the plans and specifications prepared in accordance with Section 2.1, the Authority is authorized, without the prior consent of the Participating Customers, to issue completion Bonds on a parity with the Bonds or subordinate thereto as provided in the bond resolutions or indentures authorizing issuance of the Authority's outstanding Bonds for the purpose of completing the Project in accordance with such plans and specifications. Upon the issuance of completion Bonds, the amounts to be paid to the Authority by the Participating Customer as Capital Costs shall be increased by the amount necessary to pay the principal, premium, if any, and interest on such completion Bonds and any fees attributable thereto, and to create, establish or increase any funds required by the bond resolution or indenture authorizing and securing such completion Bonds. Upon delivery of each issue of completion Bonds, the Authority shall furnish to the Participating Customers the bond resolution or indenture securing said completion Bonds and a maturity schedule showing the total annual payments of principal and interest required to retire all of the then outstanding Bonds of the Authority.

Section 8.2. Bonds Issued to Finance Additional Projects. The Authority will undertake to acquire and construct from time to time such additional Projects as are needed to: (a) provide the Participating Customers with their requirements for treated water; (b) provide such improvements, enlargements, betterments, extensions, repairs or restorations to the system as may be required to comply with any new or additional terms or conditions imposed by any regulatory agency having jurisdiction over the Authority, including but not limited to conservation and environmental regulations; (c) provide for the acquisition, construction or financing of raw water pumping and storage facilities; or (d) any other purpose permitted by the Act. When the Board of Directors of the Authority and the Participating Customers shall mutually agree as to when such additional projects are necessary and feasible, the Authority shall furnish the bond resolution or indenture for each series of Bonds to the Participating Customers for review and approval, subject to the proviso in the next sentence. The governing body of each Participating Customer, that participates in the additional Project and which is not in default under its Water Supply Contract, must vote to approve or disapprove the issuance of each series

of Bonds issued to finance an additional Project other than the Special Project Facilities described in Section 8.4; provided, however, that any Participating Customer, acting alone through its governing body, may approve an additional Project and Bonds to finance such additional Project as long as the Allocated Portion from the Initial Project is not modified (without the consent of each Participating Customer) and the Participating Customer agrees to pay all Capital Costs and all Operating Costs with respect to this additional Project. A governing body of a Participating Customer that disapproves the issuance of Bonds for an additional Project shall not be responsible for any Operating Costs or Capital Costs associated with the additional Bonds. The prior written approval of any Participating Customer is required to pledge the Participating Customer's Water Supply Contract to any Bonds for an additional Project. The Authority will authorize and use its best efforts to sell such Bonds to obtain capital funds to construct and provide the additional Project and to pay the costs of issuance of such Bonds.

Section 8.3. Refunding Bonds. The Authority reserves the right to issue refunding Bonds to refinance all or any portion of the Bonds then outstanding, and no consent of any Participating Customer shall be required so long as the issuance of such refunding Bonds does not have the effect of increasing the Capital Costs payable by the Participating Customers in any one Fiscal Year in which the refunding bonds are outstanding. If Capital Costs would be increased as a result of the Authority issuing refunding Bonds, however, the Authority shall not issue such refunding Bonds without furnishing the bond resolution authorizing such refunding Bonds to the Participating Customers for their review and approval.

Section 8.4. Bonds Issued to Finance Special Project Facilities. The Authority will reserve the right, in each of its bond resolutions or indentures authorizing the issuance of Bonds, to issue bonds or other instruments of indebtedness for the purpose of constructing or acquiring new treatment or distribution facilities or adding to, expanding or extending existing treatment or distribution facilities to serve the particular needs of any Participating Customer or Participating Customers or third parties which contract to purchase treated surface water from the Authority including, but not limited to expansion of the System Capacity to serve one or more Participating Customers when the consent required by Section 8.2 cannot be obtained. Facilities constructed or acquired with the proceeds of such bonds are hereinafter called "Special Project Facilities." The principal of and interest on such bonds shall be payable from revenues derived from payments from customers which contract on a take or pay basis to pay for such facilities and no consent shall be necessary from any of the Participating Customers. The financing costs of Special Project Facilities will not be a part of the "Capital Costs" as defined in this Contract, and the term "Bonds" as used in this Contract shall not include any issue of bonds or any portion of an issue of bonds issued to finance Special Project Facilities, nor shall expenses attributable to Special Project Facilities be included in "Operating Costs" for the purposes of setting water rates for the Participating Customers. The Authority shall apportion the System's Operating Costs and Capital Costs which would otherwise be payable by the Participating Customers to customers for whom Special Project Facilities are financed and who benefit from the use of the System pursuant to the terms of this Contract, or if this Contract is silent, in such manner as is fair and equitable to the Participating Customers and the Authority's other customers.

Section 8.5. Covenants Regarding Bonds. The Authority and the Participating Customer covenant and agree that neither of them shall use or permit to be used any of the water provided under this Contract in any manner or for any purpose which would (a) cause any Bond

to be deemed a "private activity bond" within the meaning of Section 141 of the Internal Revenue Code of 1986, as amended (the "Code"), or as an "arbitrage bond" within the meaning of Section 148 of the Code or (b) cause the interest on any Bonds not to be exempt from federal income taxation to the extent permitted by law.

Section 8.6. Sale and Offering Documents. At the request of the Authority, each of the Participating Customers shall provide to the Authority current and historical information concerning the Participating Customers' System, the financial conditions results, and prospects of the Participating Customers, and such other information concerning the Participating Customers as the Authority shall deem advisable for inclusion in the Sale and Offering Documents for the Bonds of each series and shall certify to the Authority and the underwriters of any offering of Bonds to be made by means of such Sale and Offering Documents when and if the Participating Customers deems such Sale and Offering Documents to be complete and final for purposes of the Rule. Each of the Participating Customers represents and warrants that all statements concerning it (including, without limitation, its financial condition, results, and prospects, its portion of the Participating Customers' System, and any demographic and economic information concerning the area served by its portion of the Participating Customers' System) that are contained in any Sale and Offering Document approved by the Participating Customers pursuant to Section 2.3 hereof shall be true in all material respects and shall not omit to state any material fact necessary to make the statements made in such Sale and Offering Document, in the light of the circumstances in which they are made, not misleading.

ARTICLE IX MISCELLANEOUS

Section 9.1. Authority Insurance. The Authority will maintain, or cause to be maintained, to the extent available and practicable on the basis of the advice of its insurance agent or other risk management advisor, the following insurance coverage:

(a) Insurance against loss or damage to the Participant's System by flooding, fire, lightning, vandalism and malicious mischief and other perils described in the uniform standard extended coverage endorsement to the extent of the full insurable value thereof (except for flood insurance which shall be in an amount deemed sufficient by a Consulting Engineer satisfactory to the Participating Customer to cover foreseeable damages resulting from such flooding) or replacement value thereof;

(b) Insurance against liability for bodily injury to or death of persons and for damage to or loss of property occurring on or about the Participant's System or in any way related to the operations of the Participant's System (including liability arising out of automobile accidents involving employees or agents of the Authority, while on business related to the Participant's System and general liability for the torts of the employees and agents of the Authority, both on and off the site of the Participant's System while acting within the scope of their employment), at least in the minimum amounts prescribed in the Texas Tort Claims Act, as amended, for death and bodily injury claims resulting from any one accident and the minimum amounts for property damage, with coverage in excess of the aforesaid limits, to the extent permitted by law for political subdivisions of the State and in the amounts deemed necessary by the Authority, under what is commonly known and referred to as "umbrella coverage";

(c) Workers' compensation insurance on the employees of the Authority (or employees of operator) who typically work in or about the Participant's System in such amounts as may be required by the laws of the State;

(d) Such other insurance as the Authority deems necessary to provide it adequate protection.

The Participating Customers will be named as additional insureds under each of the policies described in paragraph (b), and the Authority shall waive subrogation of workers compensation claims against the Participating Customer. All policies evidencing the insurance permitted by this Section 9.1 shall be maintained in generally recognized, responsible insurance companies or associations insuring municipal corporations qualified under the laws of the State to assume the respective risks undertaken and may be written with reasonable deductible amounts. The Authority shall upon request provide copies of all policies of insurance and insurance certificates to the Participating Customer.

Section 9.2. Participating Customer Insurance. The Participating Customer will maintain, or cause to be maintained, to the extent available and practicable on the basis of the advice of its insurance agent or other risk management advisor, the following insurance coverage:

(a) Insurance against loss or damage to the Participating Customer's system by flooding, fire, lightning, vandalism and malicious mischief and other perils described in the uniform standard extended coverage endorsement to the extent of the full insurable value thereof (except for flood insurance which shall be in an amount deemed sufficient by a consulting engineer satisfactory to the Participating Customer to cover foreseeable damages resulting from such flooding) or replacement value thereof;

(b) Insurance against liability for bodily injury to or death of persons and for damage to or loss of property occurring on or about the Participating Customer's system or in any way related to the operations of the Participating Customer's system (including liability arising out of automobile accidents involving employees or agents of the Participating Customer, while on business related to the Participating Customer's system and general liability for the torts of the employees and agents of the Participating Customer's, both on and off the site of the Participating Customer's system while acting within the scope of their employment), at least in the minimum amounts prescribed in the Texas Tort Claims Act, as amended, for death and bodily injury claims resulting from any one accident and the minimum amounts for property damage, with coverage in excess of the aforesaid limits, to the extent permitted by law for political subdivisions of the State and in the amounts deemed necessary by the Participating Customer, under what is commonly known and referred to as "umbrella coverage";

(c) Workers' compensation insurance on the employees of the Participating Customer who typically work in or about the Participating Customer's system in such amounts as may be required by the laws of the State;

(d) Such other insurance (including self insurance) as the Participating Customer deems necessary to provide it adequate protection.

The Authority will be named as additional insureds under each of the policies described in paragraph (b), and the Participating Customer shall waive subrogation of workers compensation claims against the Authority. The Participating Customer will provide the Authority with a certificate of insurance. All policies evidencing the insurance permitted by this Section 9.2 shall be maintained in generally recognized, responsible insurance companies or associations insuring municipal corporations qualified under the laws of the State to assume the respective risks undertaken and may be written with reasonable deductible amounts. The Participating Customer shall upon request provide copies of all policies of insurance and insurance certificates to the Authority.

Section 9.3. Disposition of Insurance and Condemnation Proceeds. If the Project shall be damaged or destroyed by fire or other casualty, the Authority shall apply the proceeds from any fire and extended coverage insurance either (i) to repair such damage or destruction so as to restore the Project as nearly as possible to the condition thereof immediately prior to such damage or destruction, or (ii) to construct, install, or otherwise add to the project improvements substantially equal in value to the portion of the Project which was damaged or destroyed, and of usefulness comparable to that destroyed or damaged such that the rated capacity specified elsewhere herein are maintained.

Section 9.4. No Discrimination. Subject to the last sentence of Section 5.8, the Authority covenants and agrees that there shall be no pattern of unreasonable adverse distinction and no pattern of unreasonable discrimination in carrying out its obligations under this Contract relating to the Participating Customer as compared to other Participating Customers.

Section 9.5. Approval by the Participating Customer. Whenever this Contract requires or permits approval or consent to be hereafter given by the Participating Customer, the Participating Customer agrees that such approval or consent shall not be unreasonably withheld or delayed. Such approval or consent by the Participating Customer may be evidenced by an ordinance or resolution properly adopted by the governing body of the Participating Customer or by an appropriate certificate executed by a person, firm or entity authorized to determine and give approval or consent on behalf of the Participating Customer pursuant to an ordinance or resolution adopted by the governing body of the Participating Customer. Such approval or consent shall be effective without regard to whether given before or after the time required herein and no such approval or consent of the Participating Customer shall be required as a condition to any action by the Authority except as expressly required in this Contract.

Section 9.6. Addresses and Notice. Unless otherwise provided in this Contract, any notice, communication, request, reply, or advice (herein severally and collectively, for convenience, called "Notice") herein provided or permitted to be given, made, or accepted by either party to the other must be in writing and may be given or be served by depositing the same in the United States mail postpaid and registered or certified and addressed to the party to be notified, with return receipt requested, or by delivering the same to an officer of such party, or by facsimile or other documentary form. Notice by facsimile or hand delivery shall be deemed to have been received by the close of the Business Day on which it was transmitted or hand delivered (unless transmitted or hand delivered after close, in which case it shall be deemed received at the close of the next Business Day). Notice by overnight mail or courier shall be deemed to have been received two (2) Business Days after it was sent. Notice deposited in the

mail in the manner hereinabove described shall be conclusively deemed to be effective upon deposit in the United States mail. Notice given in any other manner shall be effective only in and when received by the party to be notified. For the purpose of Notice, the addresses of the parties shall, until changed as hereinafter provided, be as follows:

If to the Authority, to:

Southmost Regional Water Authority
c/o Brownsville Public Utilities Board
1425 Robinhood Drive
Brownsville, Texas 78523
ATTN: General Manager and CEO
(956) 983-6277

If to the Participating Customer, to the address set forth on the signature page of this Contract.

The parties shall have the right from time to time and at any time to change their respective addresses and each shall have the right to specify as its address any other address by at least five (5) days' written notice to the other party.

Section 9.7. Modification. This Contract shall be subject to change or modification only with the mutual consent of the Authority and the Participating Customer, but the Participating Customer recognizes that the bond resolutions or indentures securing the Authority's Bonds may contain covenants by the Authority not to consent to certain changes or modifications of this Contract.

Section 9.8. Assignability. This Contract shall bind the respective parties and their legal successors, but shall otherwise not be assignable by the Authority without the prior consent of the Participating Customer and shall not otherwise be assignable by the Participating Customer without prior written approval of the Board of Directors of the Authority at the sole discretion of the Board of Directors of the Authority.

Section 9.9. Parties in Interest. This Contract shall be for the sole and exclusive benefit of the Authority, the Participating Customers and the owners and holders of the Bonds. The Authority is hereby granted the specific right to assign, mortgage, transfer in trust, pledge or otherwise hypothecate or encumber this Contract and the Participating Customer's obligations to make payments under this Contract to secure the Bonds.

Section 9.10. Captions. The captions appearing at the first of each numbered article and section in this Contract are inserted and included solely for convenience and shall never be considered or given any effect in construing this Contract, or any provision hereof, or in connection with the duties, obligations, or liabilities of the respective parties hereto or in ascertaining intent, if any question of intent should arise.

Section 9.11. Severability. The provisions of this Contract are severable, and if any provision or part of this Contract or the application thereof to any person or circumstance shall

ever be held by any court of competent jurisdiction to be invalid or unconstitutional for any reason, the remainder of this Contract and the application of such provision or part of this Contract to other persons or circumstances shall not be affected thereby.

Section 9.12. Exhibits. The exhibits attached hereto are incorporated herein for all purposes.

Section 9.13. Counterparts. This Contract may be executed in multiple counterparts which shall be construed as one.

Section 9.14. Merger. This Contract constitutes the entire agreement between the parties relative to the subject matter hereof. There have been and are no agreements, covenants, representations or warranties between the parties other than those expressly stated herein or expressly provided for herein.

Section 9.15. No Authority Taxes. The parties recognize that the Authority does not have taxing authority and that none of the obligations of the Authority in this Contract shall be paid or payable from ad valorem taxes.

ARTICLE X CONTINUING DISCLOSURE

Section 10.1. Annual Reports. Following the issuance of Bonds of any series, the offer or sale of which is not exempt from the Rule and, until the Participating Customers are no longer obligated, contingently or otherwise, to make payments in respect of the Bonds of such series, the Participating Customers undertake to and shall provide annually to each NRMSIR and any SID, within six months after the end of each Fiscal Year, (1) financial information and operating data of the general type included in the Sale and Offering Documents for the Bonds of such series, as specified in the Participating Customers' approval of such Sale and Offering Documents pursuant to Section 2.1 hereof and (2) audited general purpose financial statements of the Participating Customers, if then available. Any financial statements so to be provided shall be (1) prepared in accordance with generally accepted accounting principles for governmental agencies or such other accounting principles as the Participating Customers may be required to employ from time to time pursuant to state law or regulation, and (2) audited, if the Participating Customers commission an audit of such statements and the audit is completed within the period during which it must be provided. If the audit of such financial statements is not complete within such period, then the Participating Customers shall provide unaudited financial statements within the required period, and shall provide audited financial statements for the applicable Fiscal Year to each NRMSIR and any SID, when and if the audit report on such statements become available.

If the Participating Customers change their Fiscal Year, they will notify the trustee or paying agent/registrar, each NRMSIR, and any SID in writing of the change (and of the date of the new Fiscal Year end) prior to the next date by which the Participating Customers otherwise would be required to provide financial information and operating data pursuant to this Section.

respect of the Bonds of any series for so long as, but only for so long as, the Participating Customers remains an "obligated person" with respect to the Bonds of such series within the meaning of the Rule, except that the Participating Customers in any event will give notice of any deposit made in accordance with the resolution authorizing the issuance of the Bonds that causes Bonds of such series no longer to be outstanding.

The provisions of this Article are for the sole benefit of (and may be enforced by) the owners and beneficial owners of the Bonds, and nothing in this Article, express or implied, shall give any benefit or any legal or equitable right, remedy, or claim hereunder to any other person. The Participating Customers undertake to provide only the financial information, operating data, financial statements, and notices which they have expressly agreed to provide pursuant to this Article and do not hereby undertake to provide any other information that may be relevant or material to a complete presentation of the Participating Customers' financial results, condition, or prospects or hereby undertake to update any information provided in accordance with this Article or otherwise, except as expressly provided herein. The Participating Customers makes no representation or warranty concerning such information or its usefulness to a decision to invest in or sell Bonds at any future date.

UNDER NO CIRCUMSTANCES SHALL THE PARTICIPATING CUSTOMERS BE LIABLE TO THE OWNER OR BENEFICIAL OWNER OF ANY BOND OR ANY OTHER PERSON, IN CONTRACT OR TORT, FOR DAMAGES RESULTING IN WHOLE OR IN PART FROM ANY BREACH BY THE PARTICIPATING CUSTOMERS WHETHER NEGLIGENT OR WITHOUT FAULT ON ITS PART, OF ANY COVENANT SPECIFIED IN THIS ARTICLE, BUT EVERY RIGHT AND REMEDY OF ANY SUCH PERSON, IN CONTRACT OR TORT, FOR OR ON ACCOUNT OF ANY SUCH BREACH SHALL BE LIMITED TO AN ACTION FOR MANDAMUS OR SPECIFIC PERFORMANCE.

No default by the Participating Customers in observing or performing its obligations under this Article shall comprise a breach of or default under this Contract for purposes of any other provision of this Contract.


Nothing in this Article is intended or shall act to disclaim, waive, or otherwise limit the duties of the Authority or the Participating Customers under federal and state securities laws.

The provisions of this Article may be amended by the Authority and the Participating Customers from time to time to adapt to changed circumstances that arise from a change in legal requirements, a change in law, or a change in the identity, nature, status, or type of operations of the Authority or the Participating Customers, but only if (1) the provisions of this Article, as so amended, would have permitted an underwriter to purchase or sell Bonds of the applicable series in the primary offering of the Bonds of such series in compliance with the Rule, taking into account any amendments or interpretations of the Rule since such offering as well as such changed circumstances, and (2) either (a) the owners of a majority in aggregate principal amount (or any greater amount required by any other provision of this Contract that authorizes such an amendment) of the outstanding Bonds of each such series affected consent to such amendment or (b) an entity that is unaffiliated with the Authority or the Participating Customers (such as nationally recognized bond counsel) determines that such amendment will not materially impair the interest of the owners and beneficial owners of the Bonds of such series and is permitted by

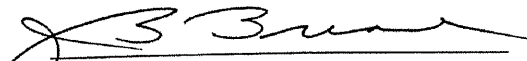
the terms of the Article. If the Authority and the Participating Customers so amend the provisions of this Article in connection with the financial or operating data which the Participating Customers are required to disclose under Section 10.1 hereof, the Participating Customers shall provide a notice of such amendment to be filed in accordance with Section 10.2(b) hereof, together with an explanation, in narrative form, of the reason for the amendment and the impact of any change in the type of financial information or operating data to be so provided. The Authority and the Participating Customers may also amend or repeal the provisions of this Article if the SEC amends or repeals the applicable provision of the Rule or a court of final jurisdiction enters judgment that such provisions of the Rule are invalid, but only if and to the extent that the provisions of this sentence would not prevent an underwriter from lawfully purchasing or selling Bonds in the primary offering of the Bonds.

IN WITNESS WHEREOF, the parties hereto have executed this Contract as of the date and year first written in this Contract.

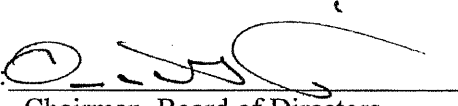
SOUTHMOST REGIONAL WATER
AUTHORITY

By: 
President

ATTEST:


Secretary

BROWNSVILLE PUBLIC UTILITIES
BOARD

By: 
Chairman, Board of Directors

Notice Address:
1425 Robinhood Drive
Brownsville, Texas 78521-3270
Telephone: (956) 983-6278
Fax: (956) 983-6289

[SEAL]

ATTEST:

By: 
Secretary, Board of Directors
Vice Chair

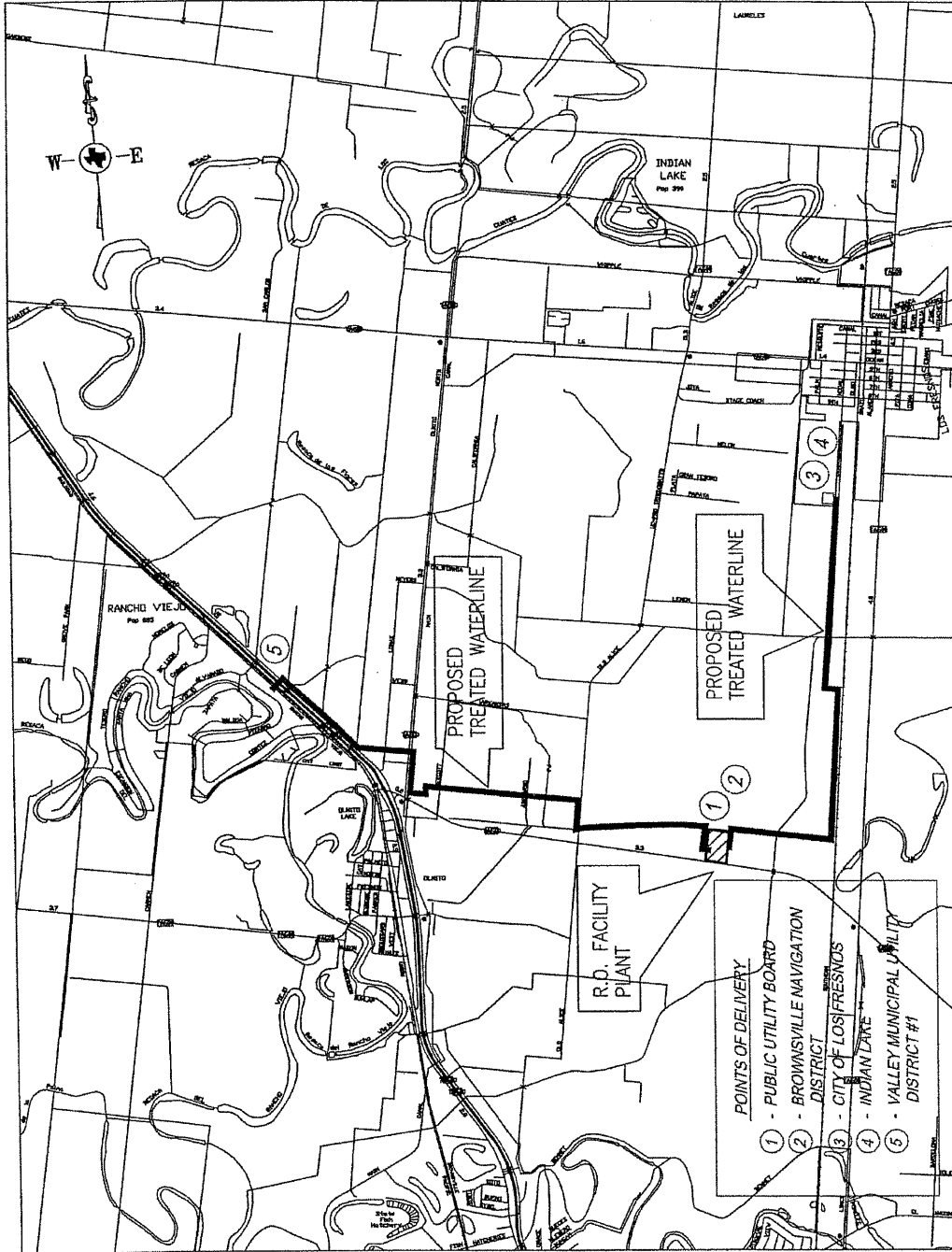
LIST OF EXHIBITS

- Exhibit "A" - Delivery Point of the Participating Customer
- Exhibit "B" - Allocated Portion of the System Capacity of the Participating Customers
- Exhibit "C" - Description of the Initial Project

EXHIBIT "A"

DELIVERY POINTS

Please see attached



- POINTS OF DELIVERY
- ① - PUBLIC UTILITY BOARD
 - ② - BROWNSVILLE NAVIGATION DISTRICT
 - ③ - CITY OF LOS FRESNOS
 - ④ - INDIAN LAKE
 - ⑤ - VALLEY MUNICIPAL UTILITY DISTRICT #1

R.O. FACILITY PLANT

PROPOSED TREATED WATERLINE

PROPOSED TREATED WATERLINE

INDIAN LAKE
Page 399

RANCHO VIEJO
Page 892

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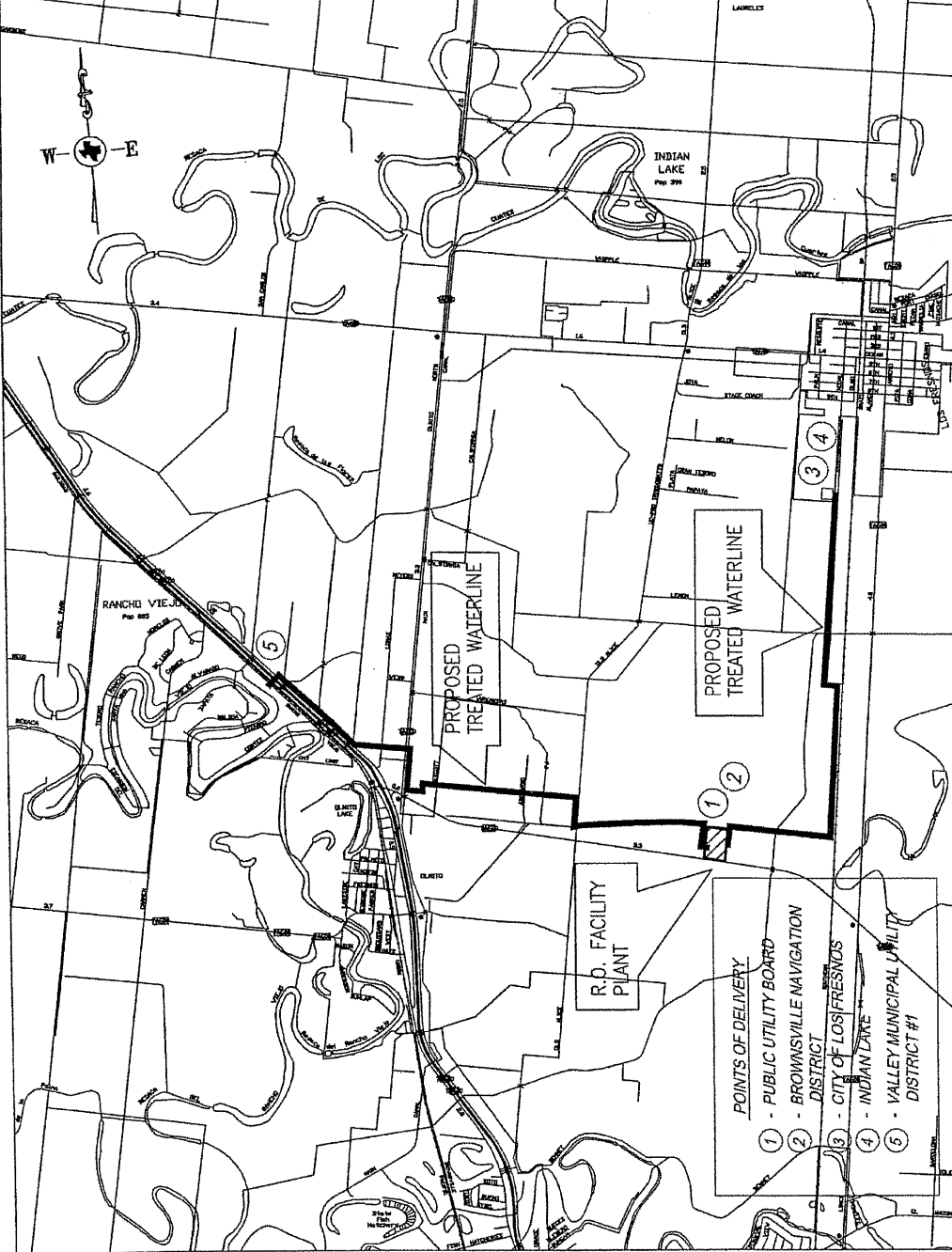


EXHIBIT "B"

ALLOCATED PORTION OF THE SYSTEM CAPACITY

<u>Participating Customer</u>	<u>Allocated Portion</u>
Brownsville Public Utilities Board	92.91%
Valley Municipal Utility District #2	2.51%
City of Los Fresnos	2.28%
Brownsville Navigation District	2.10%
Town of Indian Lake	0.20%

EXHIBIT "C"

Description of Project

The Southmost Regional Water Authority (the "Authority") was created in 1981 for the purpose of developing alternative water supply strategies for the member entities. The Authority has been dormant until resurrected by its entities in 2000 to look at the possibility of using brackish water as an alternative to the depleting Rio Grande River (the "Rio Grande") supply.

Over the last two years, since its resurrection, the Authority has determined that there is an economically feasible source of brackish ground water that can be treated to supplement the current source of the Rio Grande water. Key elements in the determination of its viability include.

- **Source of groundwater is independent of the Rio Grande flows.**
- **Treatment of brackish ground water is competitive with the treatment of surface water.**
- **Water right saving of \$2000 per acre-foot**
- **Water quality is enhanced through the reverse osmosis treatment**

The Authority soon realized the importance of establishing a regional approach to the water supply issues of the area. By joining together, the member entities enjoy the cost savings attributed to the economies of scale of a larger facility. In the operations, only one set of personnel is required rather than for multiple entities. The Authority will rely on the cheaper power cost provided by the Brownsville PUB.

Underground well testing began late 2001 and was completed in May 2002. The area tested is projected to yield 9.5 MGD brackish raw water supply source to the new treatment facility. First phase well and delivery cost will be approximately \$9 million. The Authority will continue to test additional areas and sources to add to this supply in subsequent phases.

By utilizing the reverse osmosis processes, the Authority will be able to deliver "bottle quality" water to member entities at standard treatment costs. The treatment process will remove all undesirable virus and bacteria conventional treatment methods have difficulty removing. While this process is relatively new to South Texas, it has been used in Florida and California for many years. Locally, Rancho Viejo uses this identical process to provide a portion of its water to its residents. This Rancho Viejo plant has been in operation since 2000. The Authority's proposed project is a 9.5 MGD well water supply that will yield a treated water delivery of 7.5 MGD in the first phase of operation. The treatment plant, storage, and pumping facilities are approximately \$9.5 million.

One of the major costs of the project is the infrastructure to supply each entity with its water. Over 30 miles of raw and treated water pipe is to be installed. Treated water line costs are approximately \$2.4 million. The pipelines will be sized for the future expansion, providing reduced unit cost for each expansion. It is expected that the first phase cost for each entity will be approximately \$1.40 to \$1.60 per 1000 gallons of water delivered.

Project participants include the member entities: the Brownsville Public Utilities Board (BPUB), Brownsville Navigation District (BND), Valley Municipal Utility District No. 2 (VMUD), City of Los Fresnos and the Town of Indian Lake.

Project components include the following:

**Southmost Regional Water Authority
Brackish RO Treatment Facility – Project Components**

	<u>Quantity</u>	<u>Unit</u>
Brackish Well Field		
Brackish Wells	20	Ea.
Buildings	20	Ea
Caliche Road	16	Ea
Electrical	20	Ea
SCADA	20	Ea
Electrical Service	20	Ea
Additional Test Well Analysis	20	Ea
Well Field Transmission		
8	15,300	If
10	7,300	If
12	8,000	If
14	2,700	If
16	3,600	If
24	8,000	If
30	32,000	If
Paving Replacement	1	ls
Valves and Fittings	1	ls
Highway/RR Crossings	2,700	If
<u>Brackish Water Treatment Facility</u>		
Operations/RO Building	15,900	sf
Furnishings	1	ls
Lab Furnishings	1	ls
Site Work	1	ls
Yard Piping	1	ls
SCADA	1	ls
Electrical		1 ls
6 MGD RO		6 MGD
<u>Storage and Pumping</u>		
Storage (Oversized)		7.5 MG
HS & Transfer Pumping, Chlorine & Chem Feed		1 ls
<u>Transmission System</u>		
8	20,000	LF
12	9,000	LF
16	-	LF
20	15,300	LF
24	18,000	LF
30	500	LF
Paving Replacement	1	ls
Valves and Fittings	1	ls
Highway/RR Crossings	1,200	If
<u>Miscellaneous Construction Items</u>		
Temporary Office Facilities		
Fencing		
Guard Shack and Security		
Utilities and Insurance		

Equipment
Land and ROW
Well Sites
Pipeline Sites
Plant site

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APPENDIX D

GENERAL INFORMATION REGARDING

PUBLIC UTILITIES BOARD OF THE CITY OF BROWNSVILLE, TEXAS

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PUBLIC UTILITIES BOARD OF THE CITY OF BROWNSVILLE, TEXAS

(AS OF SEPTEMBER 30, 2016)

HISTORICAL WATER CONSUMPTION (GALLONS)

Fiscal Year	Average Customers		Raw Water Pumped		Treatment Plant Capacity	Maximum Day Production		Annual Production		Water Sales		Distribution System Losses
	Number	Increase	MG	Change	MGD	MG	Change	MG	Change	MG	Change	
2007	43,713	3.16%	9,099	-17.11%	47.0	30.65	6.24%	8,085	1.27%	6,246	-5.66%	22.7%
2008	44,670	2.19%	10,007	9.98%	47.0	32.79	6.98%	8,787	8.68%	6,625	6.07%	24.6%
2009	45,143	1.06%	11,189	11.81%	47.0	38.76	18.21%	9,395	6.92%	7,062	6.60%	24.8%
2010	45,963	1.82%	7,074	-36.78%	47.0	28.25	-27.12%	8,175	-12.99%	6,322	-10.48%	22.7%
2011	46,656	1.51%	7,502	6.05%	47.0	30.48	7.89%	8,641	5.70%	7,417	17.32%	14.2%
2012	47,477	1.76%	6,743	-10.12%	47.0	29.24	-4.06%	8,253	-4.49%	7,260	-2.12%	12.0%
2013	47,976	1.05%	6,611	-1.96%	47.0	29.78	1.70%	8,176	-0.93%	7,251	-0.12%	11.3%
2014	48,510	1.11%	5,888	-10.93%	47.0	29.15	-2.11%	7,650	-6.43%	6,637	-8.47%	13.2%
2015	48,997	1.00%	5,217	-11.40%	49.3	27.46	-5.80%	7,074	-7.53%	6,055	-8.77%	14.4%
2016	49,598	1.23%	5,301	1.61%	49.3	29.15	6.16%	7,458	5.43%	6,392	5.57%	14.3%

TEN LARGEST WATER CUSTOMERS (BASED ON GALLONS CONSUMED)

Customers	Annual Consumption (1,000 Gallons)	Annual Sales Revenue	Percent of Annual Sales Revenue
El Jardin Water Supply Corporation	324,858	\$ 828,388	3.67%
Brownsville Independent School District	192,589	665,860	2.95%
Brownsville Navigation District	170,012	385,419	1.71%
Texas Southmost College	71,190	222,688	0.99%
Cameron County	71,303	190,391	0.84%
Rich Products Corp.	52,502	135,318	0.60%
University of Texas Rio Grande Valley	36,629	130,460	0.58%
Valley Baptist Medical Center	39,080	105,642	0.47%
Valley Regional Medical Center	37,229	100,320	0.44%
Trico Technologies Corp.	25,897	72,011	0.32%
Total	1,021,289	\$ 2,836,497	12.57%

MONTHLY WATER RATES (EFFECTIVE OCTOBER 1, 2016)

The Monthly Meter Charge (minimum bill) for all retail water service **INSIDE THE CITY LIMITS** of Brownsville furnished through meters of the following sizes together with the Monthly Volume Charge measured per 1,000 gallons for water usage in every instance of service for each month or fraction thereof shall be as follows:

Monthly Meter Charge		Monthly Volume Charge	
Water Meter Size (Inches)	Effective 10/1/2016	Step in Gallons	Rate Per 1,000 Gallons
5/8 x 3/4	\$ 12.06	Residential Rate	
1	22.64	0 to 3,000 gallons	\$ 1.98
1-1/2	37.55	3,001 to 9,000 gallons	2.19
2	59.90	9,001 to 16,000 gallons	2.70
3	137.70	Over 16,000 gallons	4.08
4	209.75		
6	403.38	Non-Residential Rate	2.61
8	632.69		
10	931.78		

Minimum monthly bill. The minimum monthly bill shall be equal to the customer service charge and any other taxes, surcharges, charges and/or adjustments.

Water Customers with no Metered Water Service

The rates to be charged and collected from retail customers located inside the City for non-metered water service or the availability of non-metered water by the Public Utilities Board are equal to the sum of the charges and rates itemized below and fixed as follows:

1. Single family (includes single family dwellings and mobile homes on individual lots):
\$33.88 per month per living unit (Effective 10/1/2016)
2. Duplexes, triplexes and quadruplexes (includes duplexes, triplexes and quadruplexes that are condominiums) on individual lots only where the individual tenant does not pay the bill:
\$33.88 per month per living unit (Effective 10/1/2016)
3. Duplexes, triplexes and quadruplexes (includes duplexes, triplexes and quadruplexes that are condominiums) on individual lots only where the individual tenant pays the bill:
\$33.88 per month per living unit (Effective 10/1/2016)
4. Multi-family (includes apartments, townhouses, condominiums, rooming houses, mobile home parks and like facilities) only where the individual tenant does not pay the bill:
\$33.88 per month per living unit (Effective 10/1/2016)
5. Multi-family (includes apartments, townhouses, condominiums, rooming houses, mobile home parks and like facilities) only where the individual tenant pays the bill:
\$33.88 per month per living unit (Effective 10/1/2016)

No other changes or revisions to pricing of rates, fees, and charges as specified in Section 34-46 shall be made.

The Monthly Meter Charge (minimum bill) for all retail water service **OUTSIDE THE CITY LIMITS** of Brownsville furnished through meters of the following sizes together with the Monthly Volume Charge measured per 1,000 gallons for water usage in every instance of service for each month or fraction thereof shall be as follows:

Customer Service Charge
Monthly Charge Per Connection

Monthly Meter Charge		Monthly Volume Charge	
Water Meter Size (Inches)	Effective 10/1/2016	Step in Gallons	Rate Per 1,000 Gallons
5/8 x 3/4	\$ 18.12	Residential Rate	
1	33.93	0 to 3,000 gallons	\$ 2.97
1-1/2	56.29	3,001 to 9,000 gallons	3.29
2	89.20	9,001 to 16,000 gallons	4.05
3	206.60	Over 16,000 gallons	6.12
4	314.61		
6	605.12	Non-Residential Rate	3.92
8	949.07		
10	1,397.68		

Minimum monthly bill. The minimum monthly bill shall be equal to the customer service charge and any other taxes, surcharges, charges and/or adjustments.

Wholesale Water Service

General

The rates to be charged and collected from those customers who have a wholesale water contract with BPUB for the purchase of water for resale are equal to the sum of the charges and rates itemized and fixed as follows:

Monthly Meter Charge		Monthly Volume Charge	
Water Meter Size (Inches)	Effective 10/1/2016	Step in Gallons	Rate Per 1,000 Gallons
5/8 x 3/4	\$ 12.06	General Rate without Raw Water Credit	
1	22.64		
1-1/2	37.55		
2	59.50		
3	137.70		
4	209.75		
6	403.38		
8	632.69		
10	931.78		

Minimum monthly bill. The minimum monthly bill shall be equal to the customer service charge, and any other taxes, surcharges, charges and/or adjustments.

MONTHLY SEWER RATES (EFFECTIVE OCTOBER 1, 2014)

The Monthly Meter Charge (minimum bill) for all retail sewer service **INSIDE THE CITY LIMITS** of Brownsville furnished through meters of the following sizes together with the Monthly Volume Charge measured per 1,000 gallons for water usage in every instance of service for each month or fraction thereof shall be as follows:

Customer Service Charge
Monthly Charge Per Connection

Monthly Meter Charge		Monthly Volume Charge	
Water Meter Size (Inches)	Effective 10/1/2014	Step in Gallons	Rate Per 1,000 Gallons
5/8 x 3/4	\$ 7.48	Residential Rate	
1	13.10	0 to 7,000 gallons	\$ 3.43
1-1/2	22.46	Over 7,000 gallons	3.76
2	35.36		
3	81.12	Non-residential rate	3.76
4	137.28		
6	238.16		
8	400.40		
10	647.92		

Minimum monthly bill. The minimum monthly bill shall be equal to the customer service charge, and any other taxes, surcharges, charges and/or adjustments.

Sewer Customers with no Metered Water Service

1. Single family (includes single family dwellings and mobile homes on individual lots):
\$35.26 per month per living unit (Effective 10/1/2014)
2. Duplexes, triplexes and quadruplexes (includes duplexes, triplexes and quadruplexes that are condominiums) on individual lots only where the individual tenant does not pay the bill:
\$35.26 per month per living unit (Effective 10/1/2014)
3. Duplexes, triplexes and quadruplexes (includes duplexes, triplexes and quadruplexes that are condominiums) on individual lots only where the individual tenant pays the bill:
\$35.26 per month per living unit (Effective 10/1/2014)
4. Multi-family (includes apartments, townhouses, condominiums, rooming houses, mobile home parks and like facilities) only where the individual tenant does not pay the bill:
\$35.26 per month per living unit (Effective 10/1/2014)
5. Multi-family (includes apartments, townhouses, condominiums, rooming houses, mobile home parks and like facilities) only where the individual tenant pays the bill:
\$35.26 per month per living unit (Effective 10/1/2014)
6. Non-residential: Sanitary sewage quantities shall be estimated on an individual basis to determine the monthly charge. Sanitary sewage meters may be required to determine the actual volume of sewage.

The Monthly Meter Charge (minimum bill) for all retail sewer service **OUTSIDE THE CITY LIMITS** of Brownsville furnished through meters of the following sizes together with the Monthly Volume Charge measured per 1,000 gallons for water usage in every instance of service for each month or fraction thereof shall be as follows:

Monthly Meter Charge		Monthly Volume Charge	
Water Meter Size (Inches)	Effective 10/1/2014	Step in Gallons	Rate Per 1,000 Gallons
5/8 x 3/4	\$ 11.22	Sanitary Sewage	\$ 5.65
1	19.68		
1-1/2	33.70		
2	53.04		
3	121.70		
4	205.94		
6	357.26		
8	600.62		
10	971.90		

Minimum monthly bill. The minimum monthly bill shall be equal to the customer service charge, and any other taxes, surcharges, charges and/or adjustments.

Sewer Customers with no Metered Water Service

1. Residential dwellings (includes single family dwellings and mobile homes on individual lots):
\$52.88 per month per living unit (Effective 10/1/2014)
2. Duplexes, triplexes and quadruplexes on individual lots:
\$52.88 per month per living unit (Effective 10/1/2014)
3. Multifamily (includes apartments, townhouses, condominiums, rooming houses, mobile home parks and like facilities):
\$52.88 per month per living unit (Effective 10/1/2014)
4. Nonresidential: Sanitary sewage quantities shall be estimated on an individual basis to determine the monthly charge. Sanitary sewage meters may be required to determine the actual volume of sewage.

SYSTEM HISTORICAL OPERATING RESULTS ⁽¹⁾

	Audited 2016	Audited 2015	Audited 2014	Audited 2013	Audited 2012
Operating Revenues:					
Electric System Revenue	\$ 158,650,887	\$ 160,700,951	\$ 144,656,301	\$ 122,536,547	\$ 122,600,673
Water System Revenues	23,907,813	22,601,753	22,681,564	22,282,434	22,233,114
Wastewater System Revenue	22,479,785	21,886,740	21,963,828	22,439,671	22,287,111
Total Operating Revenues	<u>\$ 205,038,485</u>	<u>\$ 205,189,444</u>	<u>\$ 189,301,693</u>	<u>\$ 167,258,652</u>	<u>\$ 167,120,898</u>
Operating Expenses:					
- Production - Fuel	\$ 9,068,657	\$ 11,241,565	\$ 17,551,493	\$ 15,766,128	\$ 10,697,530
- Production - Other than fuel	7,890,215	7,495,622	6,302,179	4,637,348	6,460,248
- Production - Oklaunion Project	12,770,410	14,033,304	16,727,489	14,327,300	11,657,930
- Production - Hidalgo Project	3,148,987	2,850,313	3,415,151	4,727,204	2,728,718
- Purchased Power	22,528,627	29,461,389	22,888,738	15,425,666	19,796,098
- Transmission & Distribution	14,984,979	14,262,019	12,756,838	10,065,685	9,585,343
Water - Supply, Pumping and Treatment	5,837,354	6,211,166	6,969,411	6,162,166	5,511,710
- Transmission and Distribution	3,082,104	2,901,226	2,743,060	2,565,614	2,514,676
Wastewater - Treatment & Pumping	8,056,155	7,979,221	8,144,738	7,289,775	7,063,964
- Collection	837,287	1,160,632	920,364	764,006	804,846
Customer Accounting	4,613,158	4,850,647	4,040,591	4,170,958	4,310,253
Administrative and General ⁽²⁾	45,886,107	27,454,728	28,418,579	27,746,485	24,950,290
Total Operating Expenses	<u>\$ 138,704,039</u>	<u>\$ 129,901,832</u>	<u>\$ 130,878,631</u>	<u>\$ 113,648,335</u>	<u>\$ 106,081,606</u>
Total Net Operating Results	<u>\$ 66,334,446</u>	<u>\$ 75,287,612</u>	<u>\$ 58,423,062</u>	<u>\$ 53,610,317</u>	<u>\$ 61,039,292</u>
Other Income (net)	(4,137,677)	(3,949,084)	(3,212,240)	(4,622,207)	(4,912,550)
Balance Available for Debt Service	<u>\$ 62,196,769</u>	<u>\$ 71,338,528</u>	<u>\$ 55,210,822</u>	<u>\$ 48,988,110</u>	<u>\$ 56,126,742</u>
Debt Service					
Priority Outstanding Series:					
Series 2005A&B Refunding Bonds	\$ 5,000	\$ 9,820,308	\$ 9,539,316	\$ 12,694,266	\$ 14,881,443
Series 2008 Priority Revenue Refunding Bonds	5,328,250	6,037,417	6,041,625	6,035,354	6,041,168
Series 2011 Priority Revenue Refunding Bonds	-	1,558,488	1,701,635	1,701,219	1,705,523
Series 2012 Priority Revenue Refunding Bonds	1,253,631	1,250,645	1,251,548	1,188,450	-
Series 2013 Priority Revenue Refunding Bonds	6,258,579	5,784,785	5,740,017	2,159,793	-
Series 2015 Priority Revenue Refunding Bonds	12,368,561	1,052,146	-	-	-
Series 2016 Priority Revenue Refunding Bonds	623,267	-	-	-	-
Total Gross Priority Debt Service	<u>25,837,288</u>	<u>25,503,789</u>	<u>24,274,141</u>	<u>23,779,082</u>	<u>22,628,134</u>
Less Capitalized Interest	-	-	-	-	-
Total Net Priority Debt Service	<u>25,837,288</u>	<u>25,503,789</u>	<u>24,274,141</u>	<u>23,779,082</u>	<u>22,628,134</u>
Subordinated Outstanding Series:					
Series 2007 Second Lien Bonds	49,415	48,770	48,864	48,971	48,040
Series 2012 Second Lien Bonds	52,155	52,054	52,280	131,050	-
Commercial Paper	-	13,671	5,929	14,359	39,891
Total Subordinated Debt Service	<u>101,570</u>	<u>114,495</u>	<u>107,073</u>	<u>194,380</u>	<u>87,931</u>
Total Debt Service	<u>\$ 25,938,858</u>	<u>\$ 25,618,284</u>	<u>\$ 24,381,214</u>	<u>\$ 23,973,462</u>	<u>\$ 22,716,065</u>
Debt Service Coverage ^{(1) (3) (4)}					
Priority Debt Average Annual	3.14	3.15	2.93	2.57	2.67
Priority & Second Lien Debt Average Annual	3.10	3.14	2.87	2.54	2.53
Balance Available After Debt Service	<u>\$ 36,257,911</u>	<u>\$ 45,720,244</u>	<u>\$ 30,829,608</u>	<u>\$ 25,014,648</u>	<u>\$ 33,410,677</u>

⁽¹⁾ Does not include Southmost Regional Water Authority, which is a component unit of the Public Utilities Board of the City of Brownsville, Texas (BPUB). Excerpts from a separate Comprehensive Annual Financial Report of BPUB are attached to this Official Statement as Appendix B.

⁽²⁾ FY 2016 Administrative and General includes the recognition of \$13,342,000 in pension expense in accordance with Governmental Accounting Standards Board (GASB) Statement No. 68, Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27. The increase in net pension liability for FY 2016 is attributable to BPUB’s approved increase in the Texas Municipal Retirement System’s matching ratio from 1.5 to 1.0 to 2.0 to 1.0 effective January 1, 2016.

⁽³⁾ Debt service coverage ratios for Junior Lien Debt have been omitted. Such coverage ratios vary based on the amount of short-term obligations issued as commercial paper that may be outstanding from time to time.

⁽⁴⁾ Debt service coverage for Priority Debt, and Priority & Junior Lien Debt shown above is based on “average annual” levelized debt principal and interest requirements through 2036. Debt service coverage based on “actual” 2016 year-end results are 2.41x for Priority Lien Debt and 2.40x for Priority & Junior Lien debt combined.

APPENDIX E

DEFINITIONS AND EXCERPTS OF INDENTURE AND
FIFTH SUPPLEMENTAL INDENTURE

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APPENDIX E

DEFINITIONS AND SELECTED PROVISIONS FROM THE INDENTURE OF TRUST AND FIFTH SUPPLEMENTAL INDENTURE OF TRUST

The following constitutes a summary of certain definitions and selected provisions of the Trust Indenture and Fifth Supplemental Trust Indenture. This summary should be qualified by reference to other provisions of the Trust Indenture and Fifth Supplemental Trust Indenture referred to elsewhere in this Official Statement, and all references and summaries pertaining to the Trust Indenture and Fifth Supplemental Trust Indenture in this Official Statement are, separately and in whole, qualified by reference to the exact terms of the Trust Indenture and Fifth Supplemental Trust Indenture, a copy of which may be obtained from the Authority.

Definitions of the Trust Indenture

Definitions

"Account" or means anyone or more, as the case may be, of the accounts from time to time thereafter created in any of the Funds required to be maintained pursuant to Section 502 of the Indenture or the provisions of any Supplemental Indenture.

"Act" means Tex. Laws 1981, 67th Legislature, Regular Session, Chapter 511 and Chapter 1371, Texas Government Code, as amended.

"Aggregate Debt Service" means for any Fiscal Year or other period, as of the date of calculation, the sum of the amounts of Debt Service for such Fiscal Year or other period with respect to anyone or more Series of Bonds, Notes and other Obligations then outstanding.

"Authority" shall mean Southmost Regional Water Authority and any other public nonprofit local government corporation, political subdivision or agency succeeding to the powers, rights, privileges, and functions of such Authority.

"Code" means the Internal Revenue Code of 1986, as amended.

"Construction Fund" means the Construction Fund established pursuant to Section 502 of the Indenture and maintained pursuant to Section 503 of the Indenture, including any Accounts created therein.

"Contract Obligations" means capitalized lease obligations, installment purchase agreements, purchase contracts or other contract agreements to acquire, purchase, improve or install the Project and contracts or purchase orders for goods and services that are acquired in the ordinary course of business, that are shown on the liability side of the balance sheet under generally accepted accounting principles. Contract Obligations may be incurred as Contract Obligations.

"Costs of Issuance" means the items of expense payable or reimbursable directly or indirectly by the Authority and related to the authorization, sale and issuance of Bonds or Notes or the authorization or incurrence of other Obligations, which items of expense will include without limiting the generality of the foregoing: travel expenses; printing costs; costs of reproducing documents; computer fees and expenses; filing and recording fees; initial fees and charges of the Trustee, Registrars, Securities Depository, and any Authenticating Agents; initial fees and charges of providers of Credit Agreements, Investment Liquidity Facilities, Reserve Fund Surety Policies, and Hedge Agreements, or other parties pursuant to remarketing, indexing or similar agreements; discounts; legal fees and charges; consulting fees and charges; auditing fees and expense; credit insurance; financial advisor's fees and charges; costs of credit ratings; insurance premiums; fees and charges for execution, transportation and safekeeping of Bonds,

Notes or Obligations; initial fees of any arbitrage consultants; and other administrative or other costs of issuing, carrying and repaying such Bonds, Notes and Obligations and investing the proceeds thereof.

"Counsel's Opinion" means an opinion signed by an attorney or firm of attorneys of nationally recognized standing in the field of law relating to municipal bonds (who may also be bond counsel to the Authority) selected by the Authority.

"Credit Agreement" means any agreement between the Authority and a third party financial institution pursuant to which such third party financial institution issues a letter of credit, municipal bond insurance policy, line of credit, standby purchase agreement, Reserve Fund Surety Policy, surety bond, or other guarantee for the purpose of enhancing the creditworthiness or liquidity of any of the Authority's obligations pursuant to any Bonds, Notes, Hedge Agreements or Contract Obligations and will include, to the extent permitted by applicable law, Investment Liquidity Facilities; and in consideration for which the Authority may agree to pay certain fees and to reimburse and repay any amounts advanced under such Credit Agreement, together with interest and other stipulated costs and charges.

"Debt Service" means, with respect to any particular Fiscal Year or other twelve (12) month period and any Series of Bonds, Notes or other Obligations, an amount equal to the sum of (a) all interest payable on such Bonds and Notes during such period, except to the extent that such interest is to be paid from amounts (including any investment earnings thereon) deposited in the Debt Service Fund, Debt Service Reserve Fund, Construction Fund, or elsewhere for the purpose of providing capitalized interest, plus (b) that portion of the principal amount of such Bonds or Notes which are due and payable during such period, plus or minus (c) net amounts payable or receivable under any Hedge Agreements during such period; provided, however, for purposes of satisfying the requirements in Article III of the Indenture (with respect to the issuance of Bonds and Notes and incurring Obligations) and determining the Reserve Fund Requirement, the following rules will apply in calculating Debt Service.

(A) Interest and principal for any Series of Bonds or Notes will be calculated on the assumption that no Bonds or Notes of any Series Outstanding on the date of calculation will cease to be Outstanding except by reason of the scheduled payment of principal on the due date thereof.

(B) Interest and principal for any Series of Notes will be calculated on the assumption that all such Notes will be continuously refinanced with other Notes or Bonds, bearing interest as provided in (C) below, so as to permit approximately equal annual amortization of Debt Service on such Series of Notes to be due and payable over a period of thirty (30) years following depletion of any amounts provided for capitalized interest on such Notes.

(C) Except as provided in (D) below, future Debt Service for any Series of Bonds or Notes which bears interest at variable rates or which will at some future date bear interest at a rate or rates to be determined or which will be subject to conversion to an interest rate or interest rate mode such that rates cannot then be ascertained will be deemed to bear interest at a rate estimated by the Financial Advisor to the Authority as the rate that would have been borne by a Series of Bonds if (i) they were secured by the same lien on Pledged Revenues, (ii) they were issued (or remarketed as the case may be) at the date of estimation and (iii) they were to bear a fixed rate of interest to their scheduled maturity or maturities.

(D) Amounts payable and/or receivable by the Authority under Hedge Agreements may be combined with payments of Debt Service on any Series of Bonds or Notes to which the Hedge Agreement relates. In such event, the Financial Advisor to the Authority will prepare a combined calculation of Debt Service with respect to the amounts payable and/or receivable under the Hedge Agreement and the amounts of interest payable under the Bonds or Notes to

which it relates, and in such calculation may offset amounts receivable by the Authority under the Hedge Agreement against interest payable on related Bonds or Notes. Any remaining (i.e. not offset) payment obligations of the Authority under the Hedge Agreement, excluding, however, any termination payments arising under such Hedge Agreement, will be treated as payments of interest for purposes of computing Debt Service and will be calculated at the rate provided in such Hedge Agreement the same as if it were an interest rate on Bonds or Notes, and if such rate is variable or otherwise not ascertainable at the time of calculation, will be estimated by Financial Advisor to the Authority in the same manner as therein provided for the estimation of Debt Service on Bonds or Notes bearing interest at variable rates or rates not ascertainable at the time of calculation. If not combined with payments of Debt Service on Bonds or Notes as set forth above, amounts payable and/or receivable by the Authority under Hedge Agreements will include only the net amount payable and/or receivable for purposes of computing Debt Service.

(E) Interest accruing on Bonds or Notes issued as capital appreciation bonds or capital appreciation notes will be treated as principal payable at maturity of such Bonds or Notes.

(F) Interest (other than on capital appreciation bonds or notes) will be deemed to accrue monthly and principal also will be deemed to accrue monthly but only during the twelve months immediately preceding any scheduled principal payment (or during such shorter periods as may be appropriate if principal payments are more frequent than every twelve months).

(G) Amounts derived from the investment of money in the Debt Service Reserve Fund during the Fiscal Year or other period of calculation will reduce Debt Service on Bonds or Notes during such Fiscal Year or other period of calculation.

(H) Credit Agreements will not be deemed to impose any additional Debt Service by reason of the repayment or reimbursement obligations that they impose.

"Debt Service Fund" means the Debt Service Fund established pursuant to Section 502 of the Indenture and maintained pursuant to Section 506 of the Indenture, including any Accounts created therein.

"Debt Service Reserve Fund" means the Debt Service Reserve Fund established pursuant to Section 502 of the Indenture and maintained pursuant to Section 507 of the Indenture, including any Accounts created therein.

"Depository" means any bank, trust company, national banking association, savings and loan association, savings bank or other banking institution or association selected by the Authority as a depository of moneys and securities held under the provisions of the Indenture and the Act, and may include the commercial banking department of the Trustee or any Paying Agent.

"Expenses" means the ongoing fees and expenses of the Authority relating to its Bonds, Notes, and other Obligations, including its fees and expenses relating to: (1) the Trustee, Paying Agents, Registrars, Authenticating Agents, Securities Dealers, Securities Depositories, or other Fiduciaries; (2) tax rebate, financial and legal consultants; (3) insurers; (4) remarketing, indexing, or similar agreements; (5) to the extent not included within the definition of Debt Service, Credit Agreements, Hedge Agreements, Investment Liquidity Facility agreements, or Reserve Fund Surety Policies.

"Fiduciary" or "Fiduciaries" means the Trustee or the Paying Agents, or any or all of them, as may be appropriate.

"First Supplemental Indenture" means the first supplemental indenture relating to the Series 2002 Bonds to finance the Project.

"Fiscal Year" shall mean the period of October 1 through September 30 of each year or such other period as is established from time to time by the Authority.

"Fund" or **"Funds"** means any one or more, as the case may be, of the separate special funds created and established or required to be maintained pursuant to Article V of the Indenture.

"Hedge Agreement" means any agreement between the Authority and a financial institution for the purpose of providing an interest rate swap, cap, collar, floor, forward or other hedging mechanism, arrangement or security, however denominated, expressly identified pursuant to its terms as being entered into in connection with and in order to hedge interest rate fluctuations on any portion of any Bonds or Notes.

"Indenture" means the Indenture of Trust, dated as of December 1, 2002, between the Authority and the Trustee, as from time to time supplemented and amended, including the First Supplemental Indenture.

"Investment Liquidity Facility" means any agreement permitted by Texas law, however denominated, provided by a financial institution which contractually commits to purchase for not less than a stated price any class or amount of Investment Securities held in the Debt Service Reserve Fund or any Account therein created under the Indenture at any time such Investment Securities must be liquidated in order to make cash transfers to the Debt Service Fund.

"Letter of Instructions" means a written directive and authorization executed by an Authorized Officer of the Authority.

"Notes" means any note or notes, as the case may be, issued in one or more Series pursuant to a commercial paper program or other borrowing program and authenticated and delivered under and pursuant to the Indenture, and secured by the Indenture.

"Obligations" means any of the following obligations of the Authority issued or incurred pursuant to the Indenture:

- (a) Any and all repayment, reimbursement or other obligations arising pursuant to any Credit Agreement;
- (b) Any and all payment obligations arising pursuant to any Hedge Agreements which may be netted against amounts, if any, due the Authority pursuant to such Hedge Agreements; and
- (c) Any and all payment obligations arising pursuant to any Contract Obligations.

In respect to the Obligations described in paragraphs (a), (b) and (c) above, if arising in connection with Reserve Fund Surety Policies or Investment Liquidity Facilities, such Obligations may be payable solely from the Debt Service Reserve Fund and the Pledged Revenues or other revenues of the Trust Estate required to be deposited therein.

"Owner(s)" means the person or entity in whose name such Bond is registered.

"Participating Customers," "each Participating Customer" or "any Participating Customer" shall mean Brownsville Public Utility Board (acting on behalf of the City of Brownsville, Texas), City of Los Fresnos, Texas, Town of Indian Lake, Texas, Valley Municipal Utility District No. 2 and Brownsville Navigation District, their respective legal successors or permitted assigns so long as such entity is a party to a Water Supply Contract with the Authority, and shall also include any purchaser of treated water from the Authority which becomes a Participating Customer pursuant to the terms of Section 3.4 of the Water Supply Contract.

"Pledged Contract Payments" means all amounts relating to Debt Service on Bonds, Notes, Obligations and Expenses payable by the Participating Customers, all as further defined and set forth in Articles I and IV of the Water Supply Contracts.

"Pledged Funds" means the following:

(a) for Bonds, Notes and Obligations, the Debt Service Fund and, to the extent created and pledged in any Supplemental Indenture, the Debt Service Reserve Fund;

(b) all monies deposited in the Debt Service Fund and the Debt Service Reserve Fund, including any investment income derived therefrom;

(c) any Reserve Fund Surety Policies purchased to satisfy the Reserve Fund Requirement for Bonds, Notes and Obligations; and

(d) for any Series of Bonds or Notes or any Obligation, such additional Funds or Accounts as will be created and pledged by Supplemental Indenture.

"Pledged Revenues" means:

(a) Pledged Contract Payments; and

(b) any additional revenues thereafter designated as Pledged Revenues.

"Project" shall mean any real or personal properties or facilities used by the Authority for the treatment, conveyance, storage or distribution of raw or treated water acquired or purchased by the Authority which constitutes a part of the System, and shall include any related real or personal property or facilities or any interest therein, and any related environmental facilities or facilities for conservation, safety and administration reasonably necessary for the operation of the System.

"Rebate Fund" means the Rebate Fund established pursuant to Section 502 of the Indenture and maintained pursuant to Section 508 of the Indenture, including any Accounts created therein.

"Regulations" means the Treasury Regulations promulgated pursuant to the Code.

"Reserve Fund Requirement" means, to the extent required in any Supplemental Indenture, not less than the average annual Aggregate Debt Service on the Bonds and Notes, as the case may be, nor more than the maximum annual Aggregate Debt Service in the current or any future Fiscal Year based upon calculations of Aggregate Debt Service on the Bonds and Notes, as the case may be, for each such Fiscal Year performed as of the date of issuance of each Series, which calculations will take into account the issuance of the Series of Bonds, Notes or Obligations being issued or incurred as of the date of calculation; provided, however, that if any Series of Bonds, Notes or Obligations will for any period of time beginning on the date of issuance be fully secured as to the payment of principal or purchase price

thereof and interest thereon during such period by the pledge of funds pursuant to a written escrow with the Trustee or any Paying Agent, then the Reserve Fund Requirement with respect to such Series will not begin to apply until such date as such Series will no longer be fully secured pursuant to such agreement.

"Reserve Fund Surety Policy" or "Reserve Fund Surety Policies" means any reserve fund surety policy or bond, letter of credit or other instrument, however denominated, provided by a financial institution, pursuant to which the Trustee may draw on such Reserve Fund Surety Policy to enable the Debt Service Reserve Fund to make a required transfer to the Debt Service Fund. Each Reserve Fund Surety Policy will meet the requirements set forth in the applicable Supplemental Indenture and will be payable on demand of the Trustee for the benefit of the Owners of the Bonds, Notes or other Obligations payable from such funds.

"System" shall mean the Project, any additional projects, and all other properties and assets, real, personal, tangible and intangible, of the Authority, now or hereafter existing and used to supply water to a Participating Customer hereunder and shall include on site general plant and administrative facilities of the Authority and all interest of the Authority in the water treatment, storage, conveyance and distribution facilities and administrative facilities of the Authority, together with all additions, betterments, extensions and improvements thereof hereafter made, together with all lands, easements and rights-of-way of the Authority and all other works, property or structures of the Authority and contract rights, water rights permits and other tangible and intangible assets of the Authority through which water is diverted from the Authority's water supply system or any other supplier of raw water, raw water storage capacity, or raw water pumping and conveyancing.

"Trust Estate" has the meaning set forth in Article II of the Indenture.

"Water Supply Contracts" shall mean the contracts between the Authority and any Participating Customer as may be amended and supplemented from time to time by any Supplemental Water Supply Contract relating to the Project.

EXCERPTS OF THE INDENTURE

* * *

ARTICLE II SECURITY OF THE BONDS AND OBLIGATIONS

Section 201 Granting Clauses. To secure the payment of the principal of, redemption premium, if any, and interest on all Bonds, Notes, Obligations and Expenses due and payable whether at maturity or by prior redemption, and the performance and observance of all of the covenants and conditions herein contained, and in consideration of the premises, the acceptance by the Trustee of the trusts hereby created, the purchase and acceptance of the Bonds, Notes and Obligations by the Owners thereof, and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the Authority does hereby GRANT, BARGAIN, CONVEY, ASSIGN, and PLEDGE to the Trustee and its successors in trust hereunder, subject to the provisions of this Indenture, all of the Authority's right, title and interest in and to the following described properties and interests, direct or indirect, whether now owned or hereafter acquired:

(a) The Pledged Revenues, including all of the Authority's right, title and interest in and to the Pledged Contract Payments;

(b) The Pledged Funds, including all moneys deposited or required to be deposited therein, and held by the Trustee as special trust funds derived from insurance proceeds, condemnation awards, payments on contractor's performance or payment bonds or other surety bonds, or any other sources.

(c) Any and all property of every kind and nature (including without limitation, cash, obligations or securities) which may from time to time hereafter be conveyed, assigned, hypothecated, endorsed, pledged, mortgaged, granted, or delivered to or deposited with, the Trustee as additional security hereunder by the Authority, or which pursuant to any of the provisions of this Indenture may come into the possession or control of the Trustee as security hereunder, or of a receiver lawfully appointed hereunder, all of which property the Trustee is authorized to receive, hold and apply as specifically set forth in this Indenture (collectively, the "Trust Estate").

* * *

ARTICLE III AUTHORIZATION AND ISSUANCE OF BONDS, NOTES AND OTHER OBLIGATIONS, GENERAL TERMS AND PROVISIONS OF THE BONDS, NOTES AND OTHER OBLIGATIONS

Section 301. Authorization of Bonds, Notes, and other Obligations.

(1) This Indenture authorizes the issuance of Bonds and Notes and the incurrence of Obligations of the Authority and creates a continuing pledge of and lien on the Trust Estate, including Pledged Revenues and Pledged Funds, to secure the full and final payment of all amounts due on such Bonds, Notes and Obligations and pay Expenses. The aggregate principal amounts of the Bonds and Notes which may be executed, authenticated and delivered under this Indenture and the aggregate amounts of any other Obligations are not limited except as may be provided herein or in any Supplemental Indenture.

(2) The Bonds and Notes may, if and when authorized by the Authority pursuant to one or more Supplemental Indentures, be issued in one or more Series, shall be designated "Contract Revenue Bonds," or "Contract Revenue Notes," as the case may be, and the designation thereof shall include such appropriate particular designation in the title for the Bonds and Notes of any particular Series, as the Authority may determine. Each Bond and Note shall bear upon its face the designation so determined for the Series to which it belongs.

(3) The Authority specifically reserves the right to issue Bonds, Notes or Obligations that may have a pledge of and lien on the Trust Estate that is junior and subordinate to other Bonds, Notes or Obligations.

Section 302. Provisions for Issuance of Bonds and Notes. The Authority has the authority to issue one or more series of Bonds or Notes provided that:

(1) All (but not less than all) of the Bonds and Notes of each Series shall be executed by the Authority for issuance under this Indenture and delivered to the Trustee, the Registrar or the Authenticating Agent and thereupon (except as provided in Section 302A or in any Supplemental Indenture) shall be authenticated by the Registrar or the Authenticating Agent and delivered to the Owners by the Trustee, the Registrar or the Authenticating Agent, but only upon the receipt of:

(a) Counsel's Opinion to the effect that, as of its date, (i) this Indenture and the Supplemental Indenture authorizing the Bonds or Notes of such Series have been duly authorized, executed and delivered by the Authority, are in full force and effect and constitute legal, valid and binding special obligations of the Authority; (ii) this Indenture and such Supplemental Indenture create the valid pledge of and lien on the Pledged Revenues and Pledged Funds which they purport to create, subject only to the provisions of this Indenture and such Supplemental Indenture permitting the application thereof for the purposes and on the terms and conditions set forth in this Indenture and such Supplemental Indenture; and (iii) the Bonds or Notes of such Series are (except as provided in Section 302A) valid binding special obligations of the Authority and entitled to the benefits of this Indenture and such Supplemental Indenture; provided, however, that the Counsel's Opinion may include an exception for limitations imposed by or resulting from bankruptcy, insolvency, moratorium, reorganization, or other laws affecting creditors' rights generally or matters relating to equitable principles;

(b) [Reserved];

(c) In the case of each Series of Bonds or Notes, a copy of the Supplemental Indenture authorizing such Bonds or Notes certified by an Authorized Officer of the Authority, which shall describe the Bonds or Notes therein authorized and shall further specify (except as provided in Section 302A):

(i) The authorized principal amount, designation and Series of such Bonds or Notes;

(ii) The purpose or purposes for which such Series of Bonds or Notes is being issued;

(iii) The maturity date or dates of the Bonds or Notes of such Series;

(iv) The interest rate or rates on the Bonds or Notes of such Series which may be fixed, variable or otherwise, and the manner of determining such rate or rates, and the Interest Payment Date or Dates therefor;

(v) The authorized denominations of and the manner of dating, numbering and lettering the Bonds or Notes of such Series;

(vi) The Paying Agent or Agents for payment of the principal and redemption price, if any, of, and interest on, the Bonds or Notes of such Series;

(vii) The Registrar for the Bonds or Notes of such Series;

(viii) The redemption price or prices, if any, and, subject to Article IV, the redemption terms for the Bonds or Notes of such Series;

(ix) The amount and due date of each mandatory redemption or sinking fund installment, if any, for Bonds or Notes of like maturity of such Series;

(x) The increased or changed Reserve Fund Requirement as of the issuance of such Series of Bonds or Notes;

(xi) How any increase or change in the Reserve Fund Requirement will be funded, including any special provisions for a Reserve Fund Surety Policy;

(xii) The forms of the Bonds or Notes of such Series;

(xiii) The appointment of any Registrar, Authenticating Agent or other agents, if any, for such Series of Bonds or Notes; and

(xiv) Any other provisions deemed advisable by the Authority not in conflict with the provisions of this Indenture.

(2) The opinion of the Attorney General of the State, if required by law, to the effect that the Bonds or Notes (except as provided in Section 302A) have been issued in accordance with law, or a judgment of a State district court validating the issuance of such Bonds or Notes. The re-approval of the Attorney General of the State shall not be required for any Bond or Bonds or Note or Notes issued in exchange, substitution or replacement of another Bond or Bonds or Note or Notes pursuant to the provisions of this Indenture or any Supplemental Indenture;

(3) Any required certificate of registration of the Bonds or Notes by the Comptroller of Public Accounts of the State of Texas; and

(4) Such further documents as are required by the provisions of this Indenture or any Supplemental Indenture.

(5) All Refunding Bonds or Notes of each Series shall be executed by the Authority for issuance under this Indenture and delivered to the Trustee or Registrar and thereupon shall be authenticated by the Trustee, Registrar, or Authentication Agent and delivered to the Authority or upon its order, but only upon the receipt by the Trustee or Registrar of the following (except as provided in Section 302A):

(a) The documents referred to in Subsection (1) of this Section;

(b) If any Bonds or Notes to be refunded are to be called for redemption, a Letter of Instructions containing irrevocable instructions to the Trustee or Registrar satisfactory to it requiring that due notice be given of redemption of the Bonds or Notes or portions thereof to be refunded on a redemption date specified in such instructions;

(c) If any Bonds or Notes are to be refunded other than by exchange and cancellation of the Bonds or Notes to be refunded, either (i) moneys in an amount sufficient to effect payment at the applicable redemption price (or the principal amount at maturity) of the Bonds or Notes to be refunded, together with accrued but unpaid interest on such Bonds or Notes to the redemption (or maturity) date, which moneys shall be held by the Trustee or any Paying Agent or any one or more escrow agents, in a separate account irrevocably in trust for and assigned to the respective Owners of the Bonds or Notes to be refunded, or (ii) Investment Securities or other obligations in such principal amounts, of such maturities, bearing such interest, and otherwise having such terms and qualifications, as shall be necessary to comply with the provisions of Subsection (2) of Section 1201 and any money required pursuant to said Subsection (2), which Investment Securities or other obligations and money shall be held in trust and used only as provided in said Subsection (2); provided, however, that neither the Trustee nor the Paying Agent shall not be responsible for any calculations necessary for actions taken in connection with this Subsection. However, Subsection 302(5)(b) shall not apply to Bonds that are issued to provide funds to pay the principal due upon the scheduled maturities of Notes issued pursuant to a commercial paper program; and

(d) If any Bonds are to be refunded, (i) a verification report reflecting such calculations necessary to show that the Investment Securities comply with Subsection 2 of Section 1201 and (ii) such further documents, opinions and moneys as are required by the provisions of Articles X or XI of this Indenture or of any Supplemental Indenture or any other provision of State or federal law.

(6) Except for the Series 2002 Bonds issued pursuant to the First Supplemental Indenture, no additional Series of Bonds or Notes shall be issued unless the following requirements are satisfied:

(a) The Water Supply Contracts shall provide for the increase or adjustment of Pledged Contract Payments under the Water Supply Contracts so that such payments will be sufficient to: (1) pay the principal and interest on said Bonds or Notes and make all mandatory redemption or sinking fund installments as required by the Supplemental Indenture authorizing such Bonds or Notes, (2) increase and/or maintain the balance in the Debt Service Reserve Fund to the Reserve Fund Requirement required by the Supplemental Indenture authorizing such Bonds or Notes, and (3) pay all related Expenses.

(b) If any obligations to be issued on a parity with the Series 2002 Bonds issued pursuant to the First Supplemental Indenture are secured by a debt service reserve fund, then such debt service reserve fund shall be fully funded upon the issuance of such parity obligations, either with cash or by a reserve fund credit instrument acceptable to the provider of the Reserve Fund Surety Policy for the Series 2002 Bonds issued pursuant to the First Supplemental Indenture, provided that such Reserve Fund Surety Policy is then in existence.

(c) If any amounts related to repayment of draws are then past due and owing to the provider of the Reserve Fund Surety Policy for the Series 2002 Bonds issued pursuant to the First

Supplemental Indenture, then prior written consent for the issuance of additional Bonds must be obtained from such provider of the Reserve Fund Surety Policy.

Section 302A. Special Provisions for Issuance of Notes.

(1) Notes of any Series may be issued as provided in Section 302 of this Indenture if the Water Supply Contracts or a Supplement to the Water Supply Contracts provides for their issuance, except as set forth below:

(a) In the event the Notes are to be issued pursuant to a commercial paper or other similar program providing for the periodic issuance and reissuance of such Notes, then:

(i) Notwithstanding anything to the contrary contained in Subsections 1(b) and 1(c) (iii) and (iv) and any other Subsection of Section 302 of this Indenture, the Supplemental Indenture may, to the greatest extent permitted by law and the Act, delegate to certain authorized officials of the Authority the power to determine the times and amounts of Notes to be issued, the maturities, interest rates, redemption provisions, if any, and other matters with respect to the terms of the Notes, so long as the Supplemental Indenture shall specify the maximum authorized principal amount of such Series of Notes that may be Outstanding at any time, shall designate the final maturity date of all Notes of such Series and shall set the maximum rate of interest that such Notes may bear.

(ii) Notwithstanding anything to the contrary contained in Subsection 1(a) of Section 302 of this Indenture, Counsel's Opinion may be to the effect that the Notes of such Series have been duly authorized by the Authority and if and when executed and delivered pursuant to the Supplemental Indenture authorizing such Series, will be in full force and effect and will constitute valid and binding special obligations of the Authority, and the opinion of the Attorney General of Texas, if such an opinion is required by law, may be to the effect that the authorizing proceedings pursuant to which the Series of Notes are to be issued, have been authorized in accordance with law.

(iii) Notwithstanding anything to the contrary contained in Subsections (1) and (5) of Section 302 of this Indenture, the Supplemental Indenture may make such provisions for the execution, authentication and delivery of the Notes of such Series from time to time, in installments, in such manner as shall be authorized and permitted by the Act.

(b) The conditions contained in Subsection (6) of Section 302 of this Indenture need not be satisfied as conditions to the issuance of any Notes if the Supplemental Indenture and Supplemental Water Supply Contracts authorizing the Series of Notes provides for their refunding and payments.

Section 302B. Special Provisions for Credit Agreements.

(1) At any time and from time to time as provided in any Supplemental Indenture, any designated Bonds, Notes or Hedge Agreements may be further secured pursuant to one or more Credit Agreements. Prior to entering into any such Credit Agreement, the Authority, to the extent required by the Act, shall cause the proceedings authorizing the Credit Agreement and any contracts or reimbursement agreements relating to such Credit Agreement to be submitted to the Attorney General of Texas for his approval.

(2) If the Credit Agreement creates an Obligation of the Authority, such Obligation must be payable and secured in one of the following ways:

(a) Credit Agreements may create Obligations payable from the Debt Service Fund and secured on a parity with Bonds, Notes and other Obligations.

(b) Credit Agreements relating to Reserve Fund Surety Policies shall be payable from and secured by the Debt Service Fund and Pledged Revenues required to be deposited into such Fund.

(3) It shall be a condition to the Authority's incurrence of any Obligation (including any reimbursement and/or repayment obligation) pursuant to a Credit Agreement that the Authority shall deliver evidence that:

(a) the Bonds, Notes or Hedge Agreements secured by such Credit Agreement were issued or incurred in compliance with the applicable requirements of Section 302, Section 302A or Section 302C, as the case may be, of this Indenture; and

(b) that all requirements of the Act have been satisfied.

(4) Upon request of the Trustee or such other party relating to the incurrence of an Obligation, general counsel to the Authority or bond counsel to the Authority shall provide an opinion stating the that conditions set forth in Section 302B(3) have been satisfied.

(5) The issuer of any Credit Agreement shall be entitled to be subrogated to the rights of the Owners of the Bonds, Notes or Hedge Agreements secured by such Credit Agreement.

Section 302C. Provisions for Hedge Agreements.

(1) At any time and from time to time as provided in any Supplemental Indenture, the Authority may enter into Hedge Agreements at or after the issuance of Bonds or Notes or in conjunction with the payment, sale, resale or exchange of any Bonds or Notes for any purpose authorized by the Act. The Authority may designate a Hedge Agreement to be a Hedge Agreement.

(2) Prior to entering into any Hedge Agreement, the following requirements shall be satisfied:

(a) evidence that the Bonds or Notes to which the Hedge Agreement relates were issued in accordance with the applicable requirements of Section 302 and Section 302A of this Indenture; and

(b) if required by law, an opinion of the Attorney General of Texas approving the transcript of proceedings authorizing the Hedge Agreement and any contracts related thereto, and determining that the proceedings of the Authority authorizing such Hedge Agreement and related contracts conform to the requirements of the Act or other applicable law.

Section 302D. Contract Obligations.

(1) To the extent permitted by law, the Authority reserves the right to incur Contract Obligations for any lawful purpose for which it may issue Bonds and Notes payable from and secured by

a lien on and pledge of Pledged Revenues; provided, however, that no Contract Obligations may be incurred unless:

(2) Prior to entering into any Contract Obligations for Credit Agreements relating to Contract Obligations, the following requirement shall be satisfied:

(a) if required by law, an opinion of the Attorney General of Texas approving the transcript of proceedings authorizing the Contract Obligation or Credit Agreements relating to Contract Obligations and any contracts related thereto, and determining that the proceedings of the Authority authorizing such Contract Obligation or Credit Agreements relating to Contract Obligations and related contracts conform to the requirements of the Act or other applicable law.

* * *

ARTICLE IV REDEMPTION OF BONDS AND NOTES

Section 401. Privilege of Redemption and Redemption Price. Bonds and Notes subject to redemption prior to maturity pursuant to a Supplemental Indenture shall be redeemable, upon notice as provided in this Article unless a different notice provision is provided for in said Supplemental Indenture, at such times, at such redemption prices and upon such terms in addition to the terms contained in this Article as may be specified in the Supplemental Indenture authorizing such Series.

Section 402. Redemption at the Election or Direction of the Authority. In the case of any redemption of Bonds or Notes at the election or direction of the Authority, the Authority shall give written notice to the Trustee, the Registrar and any Paying Agent of its election or direction so to redeem, of the redemption date, of the Series, of the principal amounts and of the redemption prices of the Bonds or Notes of each maturity of such Series to be redeemed (which Series, maturities, principal amounts and redemption prices thereof to be redeemed shall be determined by the Authority in its sole discretion, subject to any limitations with respect thereto as are contained in Section 404 of the Indenture or the Supplemental Indenture authorizing such Series). Such notice shall be given at least forty-five (45) days prior to the redemption date or such shorter period as shall be acceptable to the Registrar. In the event notice of redemption shall have been given as in Section 405 provided, there shall be paid on or before the redemption date to the appropriate Paying Agents an amount which, in addition to other moneys, if any, available therefor held by the Paying Agents, will be sufficient to redeem on the redemption date at the redemption price thereof, plus interest accrued and unpaid to the redemption date, all of the Bonds or Notes to be redeemed.

Section 403. Redemption Otherwise Than at Authority's Election or Direction. Whenever by the terms of the Indenture or any Supplemental Indenture the Trustee or the Registrar (or the Paying Agent on behalf of Registrar) is required or authorized to redeem Bonds or Notes otherwise than at the election or direction of the Authority, the Trustee, the Registrar (or Paying Agent on behalf of the Registrar), shall select the Bonds or Notes to be redeemed, give the notice of redemption and pay out moneys available therefor at the redemption price thereof, plus interest accrued and unpaid to the redemption date, to the appropriate Paying Agents in accordance with the terms of the Indenture and the Supplemental Indenture.

Section 404. Selection of Bonds and Notes to be Redeemed. If less than all of the Bonds or Notes of like maturity of any Series shall be called for prior redemption, the particular Bonds or Notes or portions thereof to be redeemed shall be selected by lot or other random method by the Registrar in such a

manner as the Registrar may determine unless otherwise provided by the Supplemental Indenture authorizing that Series.

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**ARTICLE V
ESTABLISHMENT OF FUNDS AND APPLICATION THEREOF**

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Section 502. Establishment of Funds. The following Funds may be authorized to be established and maintained under any Supplemental Indenture:

- (1) Construction Fund, which may include the proceeds of bonds or notes previously issued by the Authority;
- (2) Debt Service Fund;
- (3) Debt Service Reserve Fund; and
- (4) Rebate Fund.

All Funds and Accounts other than the Construction Fund shall be held by the Trustee. The Construction Fund may be maintained at a Depository of the Authority as directed in any Supplemental Indenture. The Authority reserves the right to establish additional Funds and Accounts for the receipt and application of proceeds of the Water Supply Contracts other than Pledged Revenues in connection with the Project. The Authority may from time to time establish Accounts and subaccounts within each Fund for such purposes as may be provided herein or in any Supplemental Indenture.

Section 503. Construction Fund.

(1) There shall be paid into the Construction Fund the amounts, including Costs of Issuance, which may be deposited to a separate Account, required to be so paid by the provisions of this Indenture and any Supplemental Indenture. There may also be paid into the Construction Fund, at the option of the Authority, any moneys received by the Authority from any source unless otherwise required to be applied by this Indenture or any Supplemental Indenture.

(2) Separate, segregated Accounts may be created within the Construction Fund and held in the manner provided in any Supplemental Indenture authorizing such Accounts. Money held in such Accounts shall be held separately from other moneys in the Construction Fund and shall be disposed of only in the manner provided in the Supplemental Indentures authorizing such Accounts. Without in any way limiting the generality of the foregoing, such separate, segregated Accounts and all funds, investments thereof and investment income earned thereon may be pledged (and a lien and security interest therein may be granted) to secure for any period of time the payment of principal of and/or the redemption price of any or all of any such Series of Bonds or Notes issued pursuant to such Supplemental Indenture or other Obligations incurred pursuant to such Supplemental Indenture and interest thereon to any date, all as may be more fully provided in such Supplemental Indenture.

(3) Amounts in the Construction Fund shall be used as provided in the Supplemental Indenture authorizing the Series of Bonds or Notes which provided money to establish the Construction Fund.

(4) Amounts in the Construction Fund may be transferred to the Debt Service Fund and applied to the payment of interest on or principal or redemption price of the Bonds or Notes or payment of other Obligations when due, to the extent provided in a Supplemental Indenture.

Section 504. Flow of Funds. Pledged Revenues shall be used to make or provide for all payments, deposits, and transfers required by this Indenture.

(1) On or before the 20th day of each month, and at such other times as shall be set forth in any Supplemental Indenture, there shall be paid into the Debt Service Fund from the Pledged Revenues, amounts which, when added to other amounts in the Debt Service Fund and available for such purposes, will provide for the accumulation in approximately equal installments of the amount required to pay the Debt Service on all Bonds, Notes and Obligations including the following:

(a) any interest to become due and payable on each Series of Outstanding Bonds and Notes on the next Interest Payment Date for such Series; and

(b) any principal scheduled to become due and payable on any Series of Bonds within the following twelve months;

(c) if provided in any Supplemental Indenture, any provision for the payment of principal on any Notes;

(d) unless otherwise provided in any Supplemental Indenture, any amounts due on Obligations;

(e) unless otherwise provided in any Supplemental Indenture, any amounts required to pay all related Expenses.

(2) After the payments and transfers set out in Subsection (1) above, if the Debt Service Reserve Fund contains less than the Reserve Fund Requirement, there shall be paid into the Debt Service Reserve Fund from Pledged Revenues the amount required, if any, by a Supplemental Indenture to attain the Reserve Fund Requirement, which transfers shall continue until the Debt Service Reserve Fund contains the Reserve Fund Requirement; provided, however, that by Supplemental Indenture, the Authority may provide for other or greater transfers in connection with the purchase or acquisition of any Reserve Fund Surety Policy.

(3) After the payments and transfers in (1) and (2) above, the remaining Pledged Revenues shall be transferred to the Rebate Fund to the extent required to satisfy the Authority's covenants contained in Section 508 of this Indenture and any similar covenants contained in any Supplemental Indenture.

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Section 506. Debt Service Fund.

(1) Unless provision for payment has been made with the Paying Agent, there shall be paid out of the Debt Service Fund on or before each Interest Payment Date for any of the Bonds and Notes, the amount required for the interest payment on such date. There shall be paid out of the Debt Service Fund on or before each principal payment date, the amount required for the principal payable on such due date on Bonds and, to the extent required by Supplemental Indenture, on Notes. On or before any redemption date for Bonds or Notes to be redeemed, there shall also be paid out of the Debt Service Fund the amount

required for the payment of the redemption price of and interest on the Bonds or Notes then to be redeemed. On or before any other payment date set forth in any Supplemental Indenture, there shall also be paid out of the Debt Service Fund the amounts required to be paid on any Obligations on such payment date.

(2) The Trustee shall, at any time at the direction of the Authority, apply amounts available in the Debt Service Fund, or from other Pledged Revenues, for the payment of any scheduled mandatory or sinking fund redemptions on Bonds issued as "term bonds" to pay the purchase price (including any brokerage and other charges) for any Bond subject to such mandatory or sinking fund redemption provided that such purchase price shall not exceed the applicable mandatory redemption price of such Bond. Upon any such purchase, the purchased Bonds shall be delivered to the Trustee or Registrar for cancellation and the principal amount of such Bonds purchased shall be credited toward the next mandatory redemption or sinking fund installment.

(3) There shall also be paid out of the Debt Service Fund any amounts required to pay Expenses related to Bonds, Notes and Obligations.

Section 507. Debt Service Reserve Fund.

(1) If on any Interest Payment Date, principal payment date, or any other date, after giving effect to all transfers pursuant to Sections 504 and 505, the amount in the Debt Service Fund shall be less than the amount required to make all payments of interest, principal, and any redemption price, of the Bonds and Notes then due and payable or to make any other then required payments on Obligations, the Trustee shall apply amounts from the Debt Service Reserve Fund to the extent necessary to make such payments.

(2) When the amount in the Debt Service Reserve Fund, together with the amounts in the Debt Service Fund, is sufficient to fully pay all Outstanding Bonds, Notes and Obligations in accordance with their terms (including principal or redemption price and interest thereon), the funds on deposit in the Debt Service Reserve Fund at the direction of the Authority may be used to pay the principal and redemption price of and interest on all Outstanding Bonds and Notes and to pay all other Obligations.

(3) In lieu of cash or Investment Securities, the Reserve Fund Requirement for the Debt Service Reserve Fund may be satisfied in whole or in part with one or more Reserve Fund Surety Policies. Such Reserve Fund Surety Policies may be drawn upon only after all other amounts in the Debt Service Reserve Fund have been used or applied, and other amounts in the Debt Service Reserve Fund may be used to reimburse and repay issuers of Reserve Fund Surety Policies for amounts drawn thereon together with interest thereon and related costs, all as may be more fully provided by Supplemental Indenture.

(4) If the amount in the Debt Service Reserve Fund exceeds the Reserve Fund Requirement and all reimbursement and repayment obligations pursuant to any Reserve Fund Surety Policy have been satisfied, the Authority may direct the Trustee to transfer such excess to the Debt Service Fund or to any other Fund or Account which shall reduce by such amount the amount otherwise required to be deposited therein, provided that such amount is used for the completion of the Project or such other Costs of the Project or Costs for which the Authority may issue Bonds or Notes. If any money is ever withdrawn from the Debt Service Reserve Fund or amounts are drawn under a Reserve Fund Surety Policy for the purpose of paying the principal of or interest on the Bonds and the Notes, the Authority shall deposit into the Debt Service Reserve Fund the amounts necessary to restore the Reserve Fund Requirement (which amounts may be deposited in equal monthly payments for a period not to exceed 12 months), or such larger balance as may be required by a Supplemental Indenture.

(5) The Authority may provide in a Supplemental Indenture that the Reserve Fund Requirement for the Debt Service Reserve Fund be funded (i) from the proceeds of Bonds or Notes, (ii) with a Reserve Fund Surety Policy, (iii) from Pledged Revenues within 12 months from the date of sale of a Series of Bonds or Notes, (iv) from any other source or (v) from any combination thereof.

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**ARTICLE VI
DEPOSITORIES OF MONEYS, SECURITY FOR DEPOSITS
AND INVESTMENT OF FUNDS**

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Section 603. Investment of Certain Funds.

(1) Moneys held in the Debt Service Fund, the Debt Service Reserve Fund and the Rebate Fund shall be invested and reinvested by the Trustee as promptly as practicable, in accordance with written instructions from the Authority, and moneys in all other Funds shall be invested and reinvested by the Authority, in each case to the fullest extent practicable and if permitted by the Act, in Investment Securities the proceeds of which the Authority estimates will be received not later than such times as shall be necessary to provide moneys when needed for payments to be made from each such other Funds. Each instruction regarding the investment of the Funds shall constitute a representation by the Authority that the securities into which such investment is directed are Investment Securities. Notwithstanding anything herein to the contrary, Investment Securities in all Funds and Accounts shall mature not later than such times as shall be necessary to provide moneys when needed for payments to be made from such Funds and Accounts; provided, however, that any Investment Securities for which the Authority or Trustee shall hold an Investment Liquidity Facility shall be deemed to have a maturity equal to the period of notice of purchase to the issuer of the Investment Liquidity Facility. Investment Securities may be acquired through the Trustee or its affiliate and the Trustee or its affiliate may receive compensation in connection therewith.

(2) Interest earned or profits realized from investing any moneys (i) representing capitalized interest for Bonds or Notes deposited in the Debt Service Fund or (ii) in the Construction Fund may be retained in such Funds. Interest earned from the investment of any moneys in any other Fund or Account may be transferred by the Authority or at the direction of the Authority into the Debt Service Fund or the Rebate Fund if required by this Indenture or any Supplemental Indenture.

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**ARTICLE VII
PARTICULAR COVENANTS OF THE AUTHORITY**

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Section 705. Maintenance of Water Supply Contracts. So long as the Bonds, Notes or Obligations remain Outstanding and unpaid, either as to principal or interest, the Authority will maintain the Water Supply Contracts in full force and effect and will use reasonable diligence to require the Participating Customers to perform and discharge each and all of the duties and obligations imposed upon the Participating Customers by the Water Supply Contracts. If the Participating Customers fail to make Pledged Contract Payments as required by the Water Supply Contracts and if it should appear that enforcement of the Water Supply Contracts has become ineffective or will be ineffective to the extent that

a default in payment of principal or interest on the Bonds, Notes or Obligations occurs or is threatened, the Authority will take all necessary action to preserve and protect the rights of the Owners of the Bonds, Notes and Obligations and to assure payment of the principal and redemption price of the Bonds, Notes and Obligations and the interest thereon.

Section 706. Maintenance of Project. So long as the Bonds, Notes or Obligations are outstanding, the Authority covenants to observe and perform all conditions, agreements and covenants contained in the Water Supply Contracts, and shall take all necessary steps to complete or cause the completion of the Project, and, upon completion, maintain and operate or cause the maintenance and operation of the Project.

Section 707. Accounts and Reports.

(1) The Authority shall keep proper books of records and accounts in which complete and correct entries shall be made of its transactions in accordance with Generally Accepted Accounting Principles. The Funds and Accounts established by the Indenture and any Supplemental Indenture, such books, and all other books and papers of the Authority, shall, to the extent permitted by law, at all times be subject to the inspection of the Owners of an aggregate of not less than 5% in principal amount of the Outstanding Bonds or Notes or their representatives duly authorized in writing. The Authority will permit such Owners of Bonds and Notes, and their agents, auditors, attorneys and counsel, at all reasonable times, to take copies and extracts from the books of record and account, all as may be reasonably necessary for the purpose of determining performance or observance by the Authority of the covenants, conditions and obligations contained in this Indenture.

(2) The Authority reserves the right to create Accounts and subaccounts within any Fund created by this Indenture or any Supplemental Indenture when in the judgment of the Authority the creation of such Accounts or subaccounts will enable the Authority to better administer the Project or regulate investments or limit returns on such investments. The Authority may, but is not obligated to, create a separate bank account for each subaccount created pursuant to this Indenture.

(3) The Authority reserves the right to employ, from time to time, any convention or method as it shall determine to be appropriate for the purpose of allocating or tracing any Pledged Revenues, or other amounts, or any proceeds or portions thereof in order to comply with applicable Federal or State laws, generally accepted accounting principles or otherwise, including without limitation for purposes of calculating any portion of revenues, debt service, operating expenses and other costs allocable to the Project for purposes of complying with any applicable conditions to any grants made to the Authority for the Project; provided, however, that no such allocation or calculation shall amend, modify or otherwise adversely impair any of the liens, pledges, trusts or grants of this Indenture.

Section 708. Restriction on Yields; Covenants as to Arbitrage Bonds and Other Tax Covenants.

(1) Except as otherwise provided in any Supplemental Indenture, the Authority will certify, through an Authorized Officer of the Authority, that based upon all facts and estimates known or reasonably expected to be in existence on the date any Series of Bonds or Notes is delivered and paid for, the Authority will reasonably expect that the proceeds of the Series will not be used in a manner that would cause the Bonds or Notes to be "arbitrage bonds" under the applicable provisions of the Code, as amended, and the Regulations prescribed thereunder. Furthermore, any Authorized Officer of the Authority is authorized and directed to provide certifications of facts, estimates and circumstances which are material to the reasonable expectations of the Authority as of the date each Series is delivered and paid for regarding the use of Bond or Note proceeds. In particular, any such Authorized Officer is

authorized to certify the reasonable expectations of the Authority on the date a Series is delivered and paid for regarding the amount and use of the proceeds of such Series and the facts and estimates on which such expectations are based. Moreover, the Authority covenants that it shall make such use of the proceeds of the Bonds and Notes, and Pledged Revenues, regulate investments of proceeds of the Bonds, Notes and Pledged Revenues, and take such other and further action as may be required so that the Bonds and Notes shall not be "arbitrage bonds" (the interest on which is not excludable from gross income for federal income tax purposes) under the applicable provisions of the Code, as amended, and the Regulations prescribed from time to time thereunder. In particular, the Authority hereby specifically reserves the right to direct the Trustee, Paying Agents and any other Fiduciaries to make specific investments to insure compliance with this Section.

(2) The Authority reserves the right to regulate and/or restrict the yield or return received on the investment of the moneys in any Fund or Account created under this Indenture or any Supplemental Indenture, if in Counsel's Opinion, such regulation or restriction is necessary in order for the interest earned on the Bonds or Notes of any Series to be excluded from gross income of the Owners thereof for federal income taxation under any statute, regulation, ruling or judicial decision.

(3) The Authority shall comply with all applicable provisions of the Regulations and the Code relating to the retention of records related to arbitrage profits and rebates.

Section 709. General. The Authority will at all times maintain its corporate existence or assure the assumption of its obligations under this Indenture by any public body succeeding to its powers under the Act, and it will use its best efforts to maintain, preserve and renew all the rights and powers provided to it by the Act. The Authority shall do and perform or cause to be done and performed all acts and things required to be done or performed by or on behalf of the Authority under the provisions of the Act, the Indenture, any Supplemental Indenture and any other law or regulation applicable to the Authority.

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ARTICLE VIII DEFAULT AND REMEDIES

Section 801. Events of Default. An Event of Default hereunder shall consist of any of the following acts or occurrences:

- (1) failure to pay when due principal or interest on any Bonds, Notes or Obligations; or
- (2) failure to deposit to the Debt Service Fund money sufficient for the payment of any principal or interest payable on any Bonds, Notes or Obligations by no later than the date when such principal or interest becomes due and payable.

For purposes of determining whether an Event of Default has occurred under this Section 801, no effect shall be given to payments made under any bond insurance policy.

Section 802. Notices. In order to provide the Authority with information with respect to its obligations under this Indenture, the Trustee shall provide the Authority a notice if there are any draws upon the Debt Service Reserve Fund which are required to be transferred to the Debt Service Fund for the payment of principal or interest on any Bonds, Notes or Obligations, together with the description of the amount drawn.

Section 803. Notice of Default. The Trustee shall also be required to give immediate notice to the Authority of the occurrence of any Event of Default hereunder.

Section 804. Remedies in General. If an Event of Default hereunder shall occur and be continuing, then, in addition to all of the other rights and remedies granted to the Trustee hereunder, the Trustee in its discretion, subject to the provisions of this Indenture, may proceed to protect and enforce its rights and the rights of the Owners of Bonds, Notes or Obligations by suit, action or proceeding in equity or at law or otherwise, whether for the specific performance of any covenant or agreement contained in this Indenture or any Supplemental Indenture or any Supplemental Indenture or in aid of the execution of any power granted in this Indenture or for the enforcement of any other legal, equitable or other remedy, as the Trustee, being advised by counsel, shall deem most effectual to protect and enforce any of the rights of the Trustee or such Owners of Bonds, Notes or Obligations, including, without limitation, the right to seek a writ of mandamus issued by a court of competent jurisdiction compelling the members of the Board or other officers of the Authority to make payment of the Pledged Revenues (but only from and to the extent of the sources provided in this Indenture or any Supplemental Indenture) or to observe and perform such covenant, obligations or conditions of this Indenture or any Supplemental Indenture.

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ARTICLE X SUPPLEMENTAL INDENTURES; AMENDMENTS TO WATER SUPPLY CONTRACTS

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Section 1001. Supplemental Indentures.

For any one or more of the following purposes and at any time or from time to time, a Supplemental Indenture of the Authority may, without the consent of, or notice to, any of the Owners, enter into a Supplemental Indenture for any of the following purposes:

1. To authorize Bonds, Notes and other Obligations and, in connection therewith, to specify and determine the matters and things referred to in Article III hereof and also any other matters and things relative to such Bonds, Notes and other Obligations which are not contrary to or inconsistent with this Indenture as theretofore in effect, or to amend, modify, or rescind any such authorization, specification, or determination at any time prior to the first delivery of such Bonds, Notes and other Obligations;
2. To close this Indenture or any Supplemental Indenture against, or provide limitations and restrictions in addition to the limitations and restrictions contained in this Indenture or any Supplemental Indenture on the delivery of Bonds, Notes and other Obligations or the issuance of other evidences or indebtedness;
3. To add to the covenants and agreements of the Authority in this Indenture or any Supplemental Indenture, other covenants and agreements to be observed by the Authority which are not contrary to or inconsistent with this Indenture or the applicable Supplemental Indentures as theretofore in effect;
4. To add to the limitations and restrictions in this Indenture or any Supplemental Indenture other limitations and restrictions to be observed by the Authority which are not contrary to or inconsistent with this Indenture or the applicable Supplemental Indenture as theretofore in effect;

5. To confirm, as further assurance, any pledge under, and the subjection to any lien or pledge created or to be created by, this Indenture or any Supplemental Indenture, of the Pledged Revenues and Pledged Funds, or to grant to Owners of Bonds or Notes additional rights or enhancements on any Bond, Note, or Credit Agreement;
6. To add or modify the provisions of this Indenture to allow for the issuance of bonds, notes or obligations that are junior and subordinate to Bonds, Notes and Obligations issued under this Indenture;
7. To modify any of the provisions of this Indenture or any Supplemental Indenture in any respect whatever, provided that (i) such modification shall be, and be expressed to be, effective only after all Outstanding Bonds, Notes and other Obligations of any Series at the date of the adoption of such Indenture or Supplemental Indenture shall cease to be Outstanding Bonds, Notes and other Obligations; and (ii) such Supplemental Indenture shall be specifically referred to in the text of such Bonds, Notes and other Obligations delivered after the date of the adoption of such Supplemental Indenture and of Bonds, Notes and other Obligations issued in exchange therefor or in place thereof;
8. To surrender any right, power or privilege reserved to or conferred upon the Authority by the terms of this Indenture, provided that the surrender of such right, power or privilege is not contrary to or inconsistent with the covenants and agreements of the Authority contained in this Indenture;
9. To add additional elements or components to the Project as now or hereafter permitted by law;
10. To increase the Reserve Fund Requirement for the Debt Service Reserve Fund or to provide for Reserve Fund Surety Policies;
11. To alter the Indenture to comply with the requirements of a nationally recognized rating agency in order to obtain or maintain a rating on the Bonds or Notes in a long-term debt rating category or in a high-quality, short-term or commercial paper rating category or of such rating agency;
12. To increase the interest rate or rates on the Bonds or Notes of any Series;
13. To designate Paying Agents, Authenticating Agents, Registrars, and other agents for the Bonds or Notes of any Series;
14. To cure any ambiguity, supply any omission, or cure or correct any defect or inconsistent provision in this Indenture;
15. To modify the Indenture to maintain or preserve federal tax exemption relating to the Bonds or Notes;
16. To insert such provisions clarifying matters or questions arising under this Indenture as are necessary or desirable and are not contrary to or inconsistent with this Indenture as theretofore in effect; and

17. To modify any of the provisions of this Indenture or any Supplemental Indenture in any respect whatsoever, provided that such action shall not adversely affect the interest of the Owners of Outstanding Bonds, Notes or other Obligations.

Section 1002. Supplemental Indentures Effective With Consent of Owners. At any time or from time to time, a Supplemental Indenture may be adopted subject to consent by Owners in accordance with and subject to the provisions of Article XI, which Supplemental Indenture, shall become fully effective in accordance with its terms as provided in said Article XI.

Section 1004. Amendment to Water Supply Contracts Not Requiring Consent of Owners. In addition to any Supplemental Water Supply Contracts into which the Participating Customers and the Authority may enter in the future, the Authority and the Participating Customers may amend, change, or modify the Water Supply Contracts without the consent of or notice to the Owners, if such amendment, change or modification: (1) is required by the provisions of the Water Supply Contracts or this Indenture; (2) cures any ambiguity or formal defect or omission; (3) is necessary to maintain or preserve the federal tax exemption of interest on the Bonds, Notes and Obligations or to comply with any state and/or federal law, including, without limitation, any applicable regulation of the Securities and Exchange Commission; (4) to subject to the lien and pledge of this Indenture to additional revenues, properties or collateral; (5) grants to or confers on the Authority additional rights, remedies, powers, or authority and the consideration given by the Authority for such amendment, modification or change does not reduce the amount payable under the Water Supply Contracts as Pledged Contract Payments, or extend the time of payment of such amounts or in any manner materially impair or adversely affect the rights of the Owners of the Bonds, Notes or Obligations; (6) enables the Authority to issue Bonds or Notes or incur Obligations; (7) enables the Authority to issue subordinate lien bonds, notes or obligations; and (8) enables such the Authority to make any change to the Water Supply Contracts provided that such change does not diminish, alter or reduce the Participating Customer's obligation and commitment to pay Pledged Contract Payments.

Section 1005. Amendment to Water Supply Contracts Requiring Consent of Owners. Except for the amendments, changes, or modifications provided in Section 1004, neither the Authority nor the Participating Customers shall consent to any amendment, change or modification of the Water Supply Contracts without publication of notice and written approval or consent of the Owners of not less than 51% in aggregate principal amount of the Bonds and Notes at the time Outstanding given, procured and established as provided in Article XII hereof relating to the amendment of this Indenture. It is specifically provided, however, that no amendment, modification or change in the Water Supply Contracts shall in any way reduce the Participating Customer's obligation to pay Pledged Contract Payments below an amount equal to the amount necessary to: (1) pay Debt Service on the Bonds, Notes and Obligations as it becomes payable; and (2) establish and maintain all of the Funds and Accounts and the balances therein as required by this Indenture.

* * *

Definitions Contained in the Fifth Supplemental Indenture

Article I
DEFINITIONS, STATUTORY AUTHORITY AND INTERPRETATIONS

SECTION 102. Definitions.

A. Except as provided in subsection B of this Section, all defined terms contained in the Indenture shall have the same meanings in this Fifth Supplemental Indenture as such defined terms are given in Section 101 of the Indenture) unless the context shall otherwise require.

B. As used in this Fifth Supplemental Indenture, the following terms shall have the following respective meanings but only for the purposes of the Series 2017 Bonds and this Fifth Supplemental Indenture.

“Bond Insurance Policy” shall mean the municipal bond new issuance insurance policy issued by the Bond Insurer that guarantees the payment of principal of and interest on the Series 2017 Bonds, if any.

“Bond Insurer” shall mean the insurer designated in the Approval Certificate or any successor thereto, if any.

“Date of Delivery” shall mean April 18, 2017.

“Dated Date” shall mean April 1, 2017.

“Fifth Supplemental Indenture” shall mean this Fifth Supplemental Indenture of Trust, dated as of April 1, 2017 authorizing the Series 2017 Bonds.

“First Supplemental Indenture” shall mean the First Supplemental Indenture of Trust, dated as of December 1, 2002 authorizing the Series 2002 Bonds.

“Fourth Supplemental Indenture” shall mean the Fourth Supplemental Indenture of Trust, dated as of September 1, 2012 authorizing the Series 2012 Bonds.

“Indenture” shall mean the Indenture of Trust, dated as of December 1, 2002, between the Authority and the Trustee, as from time to time supplemented and amended, including by the First Supplemental indenture, the Second Supplemental Indenture, the Third Supplemental Indenture, the Fourth Supplemental Indenture and the Fifth Supplemental Indenture.

“Insurance Agreement” shall mean the Insurance Agreement between the Authority and the Bond Insurer, as approved and attached to the Approval Certificate, if any.

“Interest Payment Date” shall mean March 1 or September 1 of each year as applicable commencing September 1, 2017.

“Issuance Date” shall mean the Date of Delivery of the Series 2017 Bonds to the initial purchaser or purchasers thereof against payment therefor.

“Previously Issued Bonds” shall mean the currently outstanding Series 2006 Bonds, Series 2009 Bonds and Series 2012 Bonds.

“Reserve Fund Requirement” shall mean not less than the average annual Aggregate Debt Service nor more than the maximum annual Aggregate Debt Service as of the date of issuance of the Series 2017 Bonds.

“Resolution” shall mean the resolution adopted on March 6, 2017 by the Authority of the Authority authorizing the issuance, sale, and delivery of the Series 2017 Bonds and approving the Fifth Supplemental Indenture.

“Second Supplemental Indenture” shall mean the Second Supplemental Indenture of Trust, dated as of December 1, 2006 authorizing the Series 2006 Bonds.

“Series 2002 Bonds” shall mean the Bonds authorized by the First Supplemental Indenture in the aggregate principal amount of \$30,975,000 and designated Southmost Regional Water Authority Water Supply Contract Revenue Bonds, Series 2002 (Desalination Plant Project).

“Series 2006 Bonds” shall mean the Bonds authorized by the Second Supplemental Indenture in the aggregate principal amount of \$9,950,000 and designated Southmost Regional Water Authority Water Supply Contract Revenue Refunding Bonds, Series 2006 (Desalination Plant Project).

“Series 2009 Bonds” shall mean collectively the Southmost Regional Water Authority Water Supply Contract Revenue Bonds, Series 2009A authorized by the Third Supplemental Indenture in the aggregate principal amount of \$9,295,000 and the Southmost Regional Water Authority Water Supply Contract Revenue Bonds, Series 2009B authorized by the Third Supplemental Indenture in the aggregate principal amount of \$3,795,000.

“Series 2012 Bonds” shall mean the Southmost Regional Water Authority Water Supply Contract Revenue Refunding Bonds, Series 2012 authorized by the Fourth Supplemental Indenture in the aggregate principal amount of \$13,530,000.

“Series 2017 Bonds” shall mean the Southmost Regional Water Authority Water Supply Contract Revenue Refunding Bonds, Series 2017 authorized by this Fifth Supplemental Indenture in the aggregate principal amount as designated in the Approval Certificate.

“Third Supplemental Indenture” shall mean the Third Supplemental Indenture of Trust, dated as of November 1, 2009 authorizing the Series 2009 Bonds.

“Underwriter” shall mean the underwriter designated in the offering document relating to the Series 2017 Bonds.

ARTICLE III
SOURCE OF PAYMENT; SPECIAL ACCOUNTS
AND OTHER MATTERS RELATING TO SERIES 2017 BONDS

SECTION 301. Source of Payment for Series 2017 Bonds.

A. The Series 2017 Bonds are payable solely from, and secured by a lien on and pledge of the Trust Estate, on a parity with the Previously Issued Bonds which for the Series 2017 Bonds shall include all of the Authority's right, title and interest in the Water Supply Contracts. The Owners of Series 2017 Bonds shall never have the right to demand payment out of any funds raised or to be raised by taxation or to have any claim against any property or revenues of the Participating Customers or the Authority except for Pledged Revenues and Pledged Funds described in the Indenture. The Authority does not have the power to levy or collect taxes.

B. Chapter 1208, as amended, Texas Government Code, applies to the issuance of the Series 2017 Bonds and the pledge of Pledged Revenues granted by the Authority under subsection (A) of this Section, and such pledge is therefore valid, effective, and perfected. If Texas law is amended at anytime while the Series 2017 Bonds are Outstanding and unpaid such that the pledge of the Pledged Revenues granted by the Authority is to be subject to the filing requirements of Chapter 9, Texas Business & Commerce Code, then in order to preserve to the registered owners of the Series 2017 Bonds the perfection of the security interest in this pledge, the Board of Directors of the Authority agrees to take such measures as it determines are reasonable and necessary under Texas law to comply with the applicable provisions of Chapter 9, as amended, Texas Business & Commerce Code and enable a filing to perfect the security interest in this pledge to occur.

SECTION 302. Confirmation of Funds and Establishment of Special Accounts. Pursuant to the terms of the Indenture, the existence of the following Funds is hereby confirmed:

- A. Construction Fund;
- B. Debt Service Fund;
- C. Debt Service Reserve Fund; and
- D. Rebate Fund.

For the purpose of maintaining a separate accounting of amounts allocable to Series 2017 Bonds, within certain of the Funds confirmed above, the following Accounts are hereby established:

- A. Series 2017 Construction Fund, which shall contain an account entitled Series 2017 Costs of Issuance Account;
- B. Series 2017 Debt Service Fund, which shall contain an account entitled Series 2017 Escrow Account;
- C. Debt Service Reserve Fund; and
- D. Series 2017 Rebate Account.

Complete books and records shall be maintained with respect to the allocable amounts attributable to such Series 2017 Bonds maintained in each such Account or sub-account. In

addition, in order to facilitate compliance with the covenant set forth in Article IV hereof, the Authority reserves the right to request the Trustee to establish additional rebate accounts with respect to any or all of such Accounts to account for excess arbitrage profits and interest thereon that must be accounted for or rebated to the United States of America. The Authority reserves the right to elect that the Construction Account resides with the Depository. In establishing and maintaining the foregoing Accounts, maintaining all books and records relating thereto and making disbursements therefrom, particularly to the United States of America, the Trustee and the Authority may rely from time to time upon opinions issued by nationally-recognized bond counsel to the effect that any action by the Trustee and or the Authority in reliance upon any interpretation of the Code or Regulations contained in such opinions will not cause interest on the Series 2017 Bonds to be includable in gross income for federal income tax purposes under existing law.

SECTION 303. [Reserved].

SECTION 304. Establishment of Series 2017 Reserve Fund Requirement and Disposition of Surplus. Upon the issuance of the Series 2017 Bonds, the amount of the Reserve Fund Requirement is hereby established and stipulated to be \$_____ (“Series 2017 Reserve Fund Requirement”), which is not less than the average annual Aggregate Debt Service nor more than the maximum annual Aggregate Debt Service as of the date of issuance of the Series 2017 Bonds, in accordance with the requirements of the Indenture. The Series 2017 Reserve Fund Requirement will be satisfied on the Issuance Date.

SECTION 305. Application of Net Proceeds. Net proceeds of the sale of the Series 2017 Bonds shall be applied as follows:

- A. To the Series 2017 Costs of Issuance Account within the Series 2017 Construction Fund, \$_____, which is the amount required to pay Costs of Issuance;
- B. To the Series 2017 Debt Service Fund, [\$0.00] in accrued interest;
- C. To the Series 2017 Debt Service Reserve Fund, [\$0.00], which is the amount required to fund the Series 2017 Reserve Fund Requirements; and
- D. The balance of the proceeds to the 2017 Escrow Account to pay the Refunded Bonds.

The proceeds of the Series 2017 Bonds will be released by the Trustee at the request of the Authority pursuant to the Requisition Certificate a form of which is attached as Exhibit B.

SECTION 306. Reserved.

ARTICLE IV PROVISIONS CONCERNING FEDERAL INCOME TAX EXCLUSION

A. Definitions. When used in this Section, the following terms have the following meanings:

“Code” means the Internal Revenue Code of 1986, as amended by all legislation, if any, effective on or before the Issuance Date.

“Computation Date” has the meaning set forth in Section 1.148-1(b) of the Regulations.

“Gross Proceeds” means any proceeds as defined in Section 1.148-1(b) of the Regulations, and any replacement proceeds as defined in Section 1.148-1(c) of the Regulations, of the Series 2017 Bonds.

“Investment” has the meaning set forth in Section 1.148-1(b) of the Regulations.

“Nonpurpose Investment” means any investment property, as defined in section 148(b) of the Code, in which Gross Proceeds of the Series 2017 Bonds are invested and which is not acquired to carry out the governmental purposes of the Series 2017 Bonds.

“Rebate Amount” has the meaning set forth in Section 1.148-1(b) of the Regulations.

“Regulations” means any proposed, temporary, or final Income Tax Regulations issued pursuant to sections 103 and 141 through 150 of the Code, and 103 of the Internal Revenue Code of 1954, which are applicable to the Series 2017 Bonds. Any reference to any specific Regulation shall also mean, as appropriate, any proposed, temporary or final Income Tax Regulation designed to supplement, amend or replace the specific Regulation referenced.

“Yield” of

- (a) any Investment has the meaning set forth in Section 1.148-5 of the Regulations; and
- (b) the Series 2017 Bonds has the meaning set forth in Section 1.148-4 of the Regulations.

B. Not to Cause Interest to Become Taxable. The Authority shall not use, permit the use of, or omit to use Gross Proceeds or any other amounts (or any property the acquisition, construction or improvement of which is to be financed or refinanced directly or indirectly with Gross Proceeds) in a manner which if made or omitted, respectively, would cause the interest on any Series 2017 Bond to become includable in the gross income, as defined in section 61 of the Code, of the owner thereof for federal income tax purposes. Without limiting the generality of the foregoing, unless and until the Authority receives a written opinion of counsel nationally recognized in the field of municipal bond law to the effect that failure to comply with such covenant will not adversely affect the exemption from federal income tax of the interest on any Series 2017 Bond, the Authority shall comply with each of the specific covenants in this Section.

C. No Private Use or Private Payments. Except to the extent that it will not cause the Series 2017 Bonds to become “private activity bonds” within the meaning of section 141 of the Code and the Regulations and rulings thereunder, the Authority shall at all times prior to the last Stated Maturity of the Series 2017 Bonds:

- (a) exclusively own, operate and possess all property the acquisition, construction or improvement of which is to be financed or refinanced directly or indirectly with Gross Proceeds of the Series 2017 Bonds (including property financed with Gross Proceeds of the Refunded

Bonds), and not use or permit the use of such Gross Proceeds (including all contractual arrangements with terms different than those applicable to the general public) or any property acquired, constructed or improved with such Gross Proceeds in any activity carried on by any person or entity (including the United States or any agency, department and instrumentality thereof) other than a state or local government, unless such use is solely as a member of the general public; and

(b) not directly or indirectly impose or accept any charge or other payment by any person or entity who is treated as using Gross Proceeds of the Series 2017 Bonds or any property the acquisition, construction or improvement of which is to be financed or refinanced directly or indirectly with such Gross Proceeds (including property financed with Gross Proceeds of the Refunded Bonds), other than taxes of general application within the Authority or interest earned on investments acquired with such Gross Proceeds pending application for their intended purposes.

D. No Private Loan. Except to the extent that it will not cause the Series 2017 Bonds to become “private activity bonds” within the meaning of section 141 of the Code and the Regulations and rulings thereunder, the Authority shall not use Gross Proceeds of the Series 2017 Bonds to make or finance loans to any person or entity other than a state or local government. For purposes of the foregoing covenant, such Gross Proceeds are considered to be “loaned” to a person or entity if: (1) property acquired, constructed or improved with such Gross Proceeds is sold or leased to such person or entity in a transaction which creates a debt for federal income tax purposes; (2) capacity in or service from such property is committed to such person or entity under a take-or-pay, output or similar contract or arrangement; or (3) indirect benefits, or burdens and benefits of ownership, of such Gross Proceeds or any property acquired, constructed or improved with such Gross Proceeds are otherwise transferred in a transaction which is the economic equivalent of a loan.

E. Not to Invest at Higher Yield. Except to the extent that it will not cause the Series 2017 Bonds to become “arbitrage bonds” within the meaning of section 148 of the Code and the Regulations and rulings thereunder, the Authority shall not at any time prior to the final Stated Maturity of the Series 2017 Bonds directly or indirectly invest Gross Proceeds in any Investment, if as a result of such investment the Yield of any Investment acquired with Gross Proceeds, whether then held or previously disposed of, materially exceeds the Yield of the Series 2017 Bonds.

F. Not Federally Guaranteed. Except to the extent permitted by section 149(b) of the Code and the Regulations and rulings thereunder, the Authority shall not take or omit to take any action which would cause the Series 2017 Bonds to be federally guaranteed within the meaning of section 149(b) of the Code and the Regulations and rulings thereunder.

G. Information Report. The Authority shall timely file the information required by section 149(e) of the Code with the Secretary of the Treasury on Form 8038-G or such other form and in such place as the Secretary may prescribe.

H. Rebate of Arbitrage Profits. Except to the extent otherwise provided in section 148(f) of the Code and the Regulations and rulings thereunder:

(a) The Authority shall account for all Gross Proceeds (including all receipts, expenditures and investments thereof) on its books of account separately and apart from all other funds (and receipts, expenditures and investments thereof) and shall retain all records of accounting for at least six years after the day on which the last Outstanding Bond is discharged. However, to the extent permitted by law, the Authority may commingle Gross Proceeds of the Series 2017 Bonds with other money of the Authority, provided that the Authority separately accounts for each receipt and expenditure of Gross Proceeds and the obligations acquired therewith.

(b) Not less frequently than each Computation Date, the Authority shall calculate the Rebate Amount in accordance with rules set forth in section 148(f) of the Code and the Regulations and rulings thereunder. The Authority shall maintain such calculations with its official transcript of proceedings relating to the issuance of the Series 2017 Bonds until six years after the final Computation Date.

(c) As additional consideration for the purchase of the Series 2017 Bonds by the Underwriter and the loan of the money represented thereby and in order to induce such purchase by measures designed to insure the excludability of the interest thereon from the gross income of the owners thereof for federal income tax purposes, the Authority shall pay to the United States out of the Bond Fund or its general fund, as permitted by applicable Texas statute, regulation or opinion of the Attorney General of the State of Texas, the amount that when added to the future value of previous rebate payments made for the Series 2017 Bonds equals (i) in the case of a Final Computation Date as defined in Section 1.148-3(e)(2) of the Regulations, one hundred percent (100%) of the Rebate Amount on such date; and (ii) in the case of any other Computation Date, ninety percent (90%) of the Rebate Amount on such date. In all cases, the rebate payments shall be made at the times, in the installments, to the place and in the manner as is or may be required by section 148(f) of the Code and the Regulations and rulings thereunder, and shall be accompanied by Form 8038-T or such other forms and information as is or may be required by section 148(f) of the Code and the Regulations and rulings thereunder.

(d) The Authority shall exercise reasonable diligence to assure that no errors are made in the calculations and payments required by paragraphs (2) and (3), and if an error is made, to discover and promptly correct such error within a reasonable amount of time thereafter (and in all events within one hundred eighty (180) days after discovery of the error), including payment to the United States of any additional Rebate Amount owed to it, interest thereon, and any penalty imposed under Section 1.148-3(h) of the Regulations.

I. Not to Divert Arbitrage Profits. Except to the extent permitted by section 148 of the Code and the Regulations and rulings thereunder, the Authority shall not, at any time prior to the earlier of the Stated Maturity or final payment of the Series 2017 Bonds, enter into any transaction that reduces the amount required to be paid to the United States pursuant to Subsection H of this Section because such transaction results in a smaller profit or a larger loss than would have resulted if the transaction had been at arm's length and had the Yield of the Series 2017 Bonds not been relevant to either party.

J. Bonds Not Hedge Bonds.

(a) At the time the original bonds refunded by the Series 2017 Bonds were issued, the Authority reasonably expected to spend at least 85% of the spendable proceeds of such bonds within three years after such bonds were issued.

(b) Not more than 50% of the proceeds of the original bonds refunded by the Series 2017 Bonds were invested in Nonpurpose Investments having a substantially guaranteed Yield for a period of 4 years or more.

(c) The Authority reasonably expects to spend 85% of the spendable years after the date of issuance thereof.

K. Current Refunding of the Refunded Bonds. The Series 2017 Bonds are issued, in part, to refund the Refunded Bonds, and the Series 2017 Bonds will be issued, and certain proceeds thereof used, within 90 days after the Date of Delivery for the redemption of such Refunded Bonds. In the issuance of the Series 2017 Bonds, the Authority has employed no “device” to obtain a material financial advantage (based on arbitrage), within the meaning of section 149(d)(4) of the Code, apart from savings attributable to lower interest rates. The Authority has complied with the covenants, representations, and warranties contained in the documents executed in connection with the issuance of the Refunded Bonds.

L. Elections. The Authority hereby directs and authorizes the President and Secretary of the Board, or the Deputy Secretary/Treasurer, either or any combination of the foregoing, to make such elections in the Certificate as to Tax Exemption or similar or other appropriate certificate, form, or document permitted or required pursuant to the provisions of the Code or the Regulations, as they deem necessary or appropriate in connection with the Series 2017 Bonds. Such elections shall be deemed to be made on the Issuance Date.

SECTION 402. Continuing Obligation. Notwithstanding any other provision of this Fifth Supplemental Indenture, the Authority’s obligations under the covenants and provisions of this Section shall survive the defeasance and discharge of the Series 2017 Bonds.

ARTICLE V CONTINUING DISCLOSURE UNDERTAKING

SECTION 501. Definitions. As used in this Section, the following terms have the meanings ascribed to such terms below:

EMMA means the MSRB’s Electronic Municipal Market Access system, accessible by the general public, without charge, on the internet through the uniform resource locator (URL) <http://www.emma.msrb.org>.

MSRB means the Municipal Securities Rulemaking Board.

Rule means SEC Rule 15c2-12, as amended from time to time.

SEC means the United States Securities and Exchange Commission.

SECTION 502. Annual Reports. The Authority shall file annually with the MSRB, (1) within six months after the end of each fiscal year of the Authority ending in or after 2017, financial information and operating data with respect to the Authority of the general type included in the final Official Statement for the Series 2017 Bonds, being the information described in Appendix A, B, and D to the Official Statement, and (2) if not provided as part such financial information and operating data, audited financial statements of the Authority, when and if available. Any financial statements so to be provided shall be (i) prepared in accordance with the accounting principles described in the Authority's financial statement included as an appendix to the Official Statement in Appendix A or such other accounting principles as the Authority may be required to employ from time to time pursuant to state law or regulation, and (ii) audited, if the Authority commissions an audit of such statements and the audit is completed within the period during which they must be provided. If the audit of such financial statements is not complete within such period, then the Authority shall file unaudited financial statements within such period and audited financial statements for the applicable fiscal year to the MSRB, when and if the audit report on such financial statements becomes available.

If the Authority changes its fiscal year, it will file notice thereof with the MSRB of the change (and of the date of the new fiscal year end) prior to the next date by which the Authority otherwise would be required to provide financial information and operating data pursuant to this Article.

SECTION 503. Notice of Certain Events. The Authority shall file notice of any of the following events with respect to the Series 2017 Bonds to the MSRB in a timely manner and not more than 10 business days after occurrence of the event:

- (a) Principal and interest payment delinquencies;
- (b) Non-payment related defaults, if material;
- (c) Unscheduled draws on debt service reserves reflecting financial difficulties;
- (d) Unscheduled draws on credit enhancements reflecting financial difficulties;
- (e) Substitution of credit or liquidity providers, or their failure to perform;
- (f) Adverse tax opinions, the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB), or other material notices or determinations with respect to the tax status of the Series 2017 Bonds, or other material events affecting the tax status of the Series 2017 Bonds;
- (g) Modifications to rights of Holders of the Series 2017 Bonds, if material;
- (h) Series 2017 Bond calls, if material, and tender offers;
- (i) Defeasances;
- (j) Release, substitution, or sale of property securing repayment of the Series 2017 Bonds, if material;

- (k) Rating changes;
- (l) Bankruptcy, insolvency, receivership, or similar event of the Authority, which shall occur as described below;
- (m) The consummation of a merger, consolidation, or acquisition involving the Authority or the sale of all or substantially all of its assets, other than in the ordinary course of business, the entry into of a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material; and
- (n) Appointment of a successor or additional trustee or the change of name of a trustee, if material.

For these purposes, any event described in the immediately preceding paragraph (12) is considered to occur when any of the following occur: the appointment of a receiver, fiscal agent, or similar officer for the Authority in a proceeding under the United States Bankruptcy Code or in any other proceeding under state or federal law in which a court or governmental authority has assumed jurisdiction over substantially all of the assets or business of the Authority, or if such jurisdiction has been assumed by leaving the existing governing body and officials or officers in possession but subject to the supervision and orders of a court or governmental authority, or the entry of an order confirming a plan of reorganization, arrangement, or liquidation by a court or governmental authority having supervision or jurisdiction over substantially all of the assets or business of the Authority.

The Authority shall file notice with the MSRB, in a timely manner, of any failure by the Authority to provide financial information or operating data in accordance with this Article by the time required by Section 502 hereof.

SECTION 504. Limitations, Disclaimers, and Amendments. The Authority shall be obligated to observe and perform the covenants specified in this Article for so long as, but only for so long as, the Authority remains an “obligated person” with respect to the Series 2017 Bonds within the meaning of the Rule, except that the Authority in any event will give notice of any deposit that causes the Series 2017 Bonds to be no longer Outstanding.

The provisions of this Article are for the sole benefit of the Holders and beneficial owners of the Series 2017 Bonds, and nothing in this Article, express or implied, shall give any benefit or any legal or equitable right, remedy, or claim hereunder to any other person. The Authority undertakes to provide only the financial information, operating data, financial statements, and notices which it has expressly agreed to provide pursuant to this Article and does not hereby undertake to provide any other information that may be relevant or material to a complete presentation of the Authority’s financial results, condition, or prospects or hereby undertake to update any information provided in accordance with this Article or otherwise, except as expressly provided herein. The Authority does not make any representation or warranty concerning such information or its usefulness to a decision to invest in or sell Series 2017 Bonds at any future date.

UNDER NO CIRCUMSTANCES SHALL THE AUTHORITY BE LIABLE TO THE HOLDER OR BENEFICIAL OWNER OF ANY SERIES 2017 BOND OR ANY OTHER PERSON, IN

CONTRACT OR TORT, FOR DAMAGES RESULTING IN WHOLE OR IN PART FROM ANY BREACH BY THE AUTHORITY, WHETHER NEGLIGENT OR WITH OR WITHOUT FAULT ON ITS PART, OF ANY COVENANT SPECIFIED IN THIS ARTICLE, BUT EVERY RIGHT AND REMEDY OF ANY SUCH PERSON, IN CONTRACT OR TORT, FOR OR ON ACCOUNT OF ANY SUCH BREACH SHALL BE LIMITED TO AN ACTION FOR MANDAMUS OR SPECIFIC PERFORMANCE.

No default by the Authority in observing or performing its obligations under this Article shall constitute a breach of or default under the Indenture for purposes of any other provision of the Indenture.

Nothing in this Article is intended or shall act to disclaim, waive, or otherwise limit the duties of the Authority under federal and state securities laws.

The provisions of this Article may be amended by the Authority from time to time to adapt to changed circumstances that arise from a change in legal requirements, a change in law, or a change in the identity, nature, status, or type of operations of the Authority, but only if (1) the provisions of this Article, as so amended, would have permitted an underwriter to purchase or sell Series 2017 Bonds in the primary offering of the Series 2017 Bonds in compliance with the Rule, taking into account any amendments or interpretations of the Rule to the date of such amendment, as well as such changed circumstances, and (2) either (a) the Holders of a majority in aggregate principal amount (or any greater amount required by any other provision of the Indenture that authorizes such an amendment) of the Outstanding Series 2017 Bonds consent to such amendment or (b) a person that is unaffiliated with the Authority (such as nationally recognized bond counsel) determines that such amendment will not materially impair the interests of the Holders and beneficial owners of the Series 2017 Bonds. The Authority may also repeal or amend the provisions of this Article if the SEC amends or repeals the applicable provisions of the Rule or any court of final jurisdiction enters judgment that such provisions of the Rule are invalid, and the Authority also may amend the provisions of this Article in its discretion in any other manner or circumstance, but in either case only if and to the extent that the provisions of this sentence would not have prevented an underwriter from lawfully purchasing or selling Series 2017 Bonds in the primary offering of the Series 2017 Bonds, giving effect to (a) such provisions as so amended and (b) any amendments or interpretations of the Rule. If the Authority so amends the provisions of this Article, the Authority shall include with any amended financial information or operating data next provided in accordance with this Article an explanation, in narrative form, of the reasons for the amendment and of the impact of any change in the type of financial information or operating data so provided.

SECTION 505. Information Format – Incorporation by Reference. The Authority information required under this Article shall be filed with the MSRB through EMMA in such format and accompanied by such identifying information as may be specified from time to time thereby. Under the current rules of the MSRB, continuing disclosure documents submitted to EMMA must be in word-searchable portable document format (PDF) files that permit the document to be saved, viewed, printed, and retransmitted by electronic means and the series of obligations to which such continuing disclosure documents relate must be identified by CUSIP number or numbers.

Financial information and operating data to be provided pursuant to this Article may be set forth in full in one or more documents or may be included by specific reference to any document (including an official statement or other offering document) available to the public through EMMA or filed with the SEC.

APPENDIX F

FORM OF BOND COUNSEL'S OPINION

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April 18, 2017

WE HAVE ACTED as Bond Counsel for the SOUTHMOST REGIONAL WATER AUTHORITY, a political subdivision and municipal corporation of the State of Texas (the "Authority") in connection with an issue of bonds (the "Bonds") described as follows:

SOUTHMOST REGIONAL WATER AUTHORITY WATER SUPPLY CONTRACT REVENUE REFUNDING BONDS, SERIES 2017 (DESALINATION PLANT PROJECT), in the aggregate principal amount of \$9,255,000 maturing on September 1 in the year 2019 and the years 2028 through 2032, inclusive. The Bonds are issuable in fully registered form only, in denominations of \$5,000 or any integral multiple thereof, bear interest, and may be transferred and exchanged as set out in the Bonds and in the resolution (the "Resolution") adopted by the Board of Directors of the Authority (the "Board") on March 6, 2017 and an Indenture of Trust, dated as of December 1, 2002 and a Fifth Supplemental Indenture of Trust, dated as of April 1, 2017 (collectively, the "Indenture").

WE HAVE ACTED as Bond Counsel for the sole purpose of rendering an opinion with respect to the legality and validity of the Bonds under the Constitution and laws of the State of Texas and with respect to the exclusion of interest on the Bonds from gross income under federal income tax law. In such capacity we have examined the Constitution and laws of the State of Texas; federal income tax law; and a transcript of certain certified proceedings pertaining to the issuance of the bonds that are being refunded with the proceeds of the Bonds (the "Refunded Bonds"), as described in the Resolution and the Indenture. The transcript contains certified copies of certain proceedings of the Authority and U.S. Bank National Association, the paying agent/registrant and trustee for the Refunded Bonds (the "Trustee"); the certificate (the "Sufficiency Certificate") of Estrada Hinojosa & Company, Inc., which verifies the sufficiency of the deposit made with the Trustee for the defeasance of the Refunded Obligations; certain certifications and representations and other material facts within the knowledge and control of the Authority, upon which we rely; and certain other customary documents and instruments authorizing and relating to the issuance of the Bonds and the firm banking and financial arrangements for the discharge and final payment of the Refunded Bonds. We have also examined executed Bond No. T-1 of this issue.

WE HAVE NOT BEEN REQUESTED to examine, and have not investigated or verified, any original proceedings, records, data or other material, but have relied upon the transcript of certified proceedings. We have not assumed any responsibility with respect to the financial

condition or capabilities of the Authority or the disclosure thereof in connection with the sale of the Bonds. Our role in connection with the Authority's Official Statement prepared for use in connection with the sale of the Bonds has been limited as described therein.

BASED ON SUCH EXAMINATION, it is our opinion as follows:

(1) The transcript of certified proceedings evidences complete legal authority for the issuance of the Bonds in full compliance with the Constitution and laws of the State of Texas presently in effect; the Bonds constitute valid and legally binding obligations of the Authority enforceable in accordance with the terms and conditions thereof, except to the extent that the rights and remedies of the owners of the Bonds may be limited by laws heretofore or hereafter enacted relating to bankruptcy, insolvency, reorganization, or moratorium or other similar laws affecting the rights of creditors of political subdivisions and the exercise of judicial discretion in appropriate cases; and the Bonds have been authorized and delivered in accordance with law;

(2) The Bonds are payable, both as to principal and interest, from and are equally and ratably secured, together with the currently outstanding Previously Issued Bonds (as defined in the Indenture), by a lien on and pledge of the Trust Estate (as defined in the Indenture); and

(3) The deposits made with the Trustee constitute the making of firm banking and financial arrangements for the discharge and final payment of the Refunded Bonds; in reliance upon the representations contained in the Sufficiency Certificate, the Refunded Bonds, having been discharged and paid, are no longer outstanding and the lien on and pledge of Pledged Revenues as set forth in the resolution authorizing their issuance will be appropriately and legally defeased; the holders of the Refunded Bonds may obtain payment of the principal of, redemption premium, if any, and interest in the Refunded Bonds only out of the funds provided therefor now held for that purpose by the Trustee and therefore the Refunded Bonds are deemed to be fully paid and no longer outstanding, except for the purpose of being paid from the funds provided therefor.

IT IS OUR FURTHER OPINION, also based on our examination as described above, and subject to the restrictions hereinafter described, that, pursuant to section 103 of the Internal Revenue Code of 1986, as amended to the date hereof (the "Code"), and existing regulations, published rulings, and court decisions thereunder, and assuming continuing compliance by the Authority with the provisions of the Resolution after the date hereof, interest on the Bonds (1) will be excludable from the gross income, as defined in section 61 of the Code, of the owners thereof for federal income tax purposes, and (2) will not be included in computing the alternative minimum taxable income for federal income tax purposes of the owners thereof who are individuals or, except as described below, corporations. The opinion set forth in the first sentence of this paragraph is subject to the condition that the Authority comply with all requirements of the Internal Revenue Code of 1986, as amended (the "Code"), that must be satisfied subsequent to the issuance of the Bonds in order that interest thereon be, or continue to be, excluded from gross income for federal income tax purposes. The Authority has covenanted in the Resolution to

comply with each such requirement. The Code and the existing regulations, rulings and court decisions thereunder, upon which the foregoing opinions of Bond Counsel are based, are subject to change, which could prospectively or retroactively result in the inclusion of the interest on the Bonds in gross income of the owners thereof for federal income tax purposes. We have further relied on the representations contained in the Sufficiency Certificate. If such representations are determined to be inaccurate or incomplete or the Authority fails to comply with the foregoing provisions of the Resolution, interest on the Bonds could become includable in gross income from the date of original delivery, regardless of the date on which the event causing such inclusions occurs.

WE CALL TO YOUR ATTENTION THAT, with respect to our opinion in clause (2) of the previous paragraph, interest on the Bonds owned by a corporation will be included in such corporation's adjusted current earnings for purposes of calculating the alternative minimum taxable income of such corporation, other than an S corporation, a qualified mutual fund, a real estate mortgage investment conduit (REMIC), a real estate investment trust (REIT), or a financial asset securitization investment trust (FASIT). A corporation's alternative minimum taxable income is the basis on which the alternative minimum tax imposed by section 55 of the Code is computed.

EXCEPT AS DESCRIBED ABOVE, we express no opinion as to any federal, state or local tax consequences under present law, or future legislation, resulting from the ownership of, receipt or accrual of interest on, or the acquisition or disposition of, the Bonds. Prospective purchasers of the Bonds should be aware that the ownership of tax-exempt obligations, such as the Bonds, may result in collateral federal tax consequences to, among others, financial institutions, life insurance companies, property and casualty insurance companies, certain foreign corporations doing business in the United States, certain S corporations with Subchapter C earnings and profits, individual recipients of Social Security or Railroad Retirement benefits, taxpayers who are deemed to have incurred or continued indebtedness to purchase or carry tax-exempt obligations, taxpayers owning an interest in a FASIT that holds tax-exempt obligations and individuals otherwise qualified for the earned income tax credit. Prospective purchasers should consult their tax advisors as to the consequences of investing in the Bonds.

OUR OPINIONS ARE BASED ON EXISTING LAW, which is subject to change. Such opinions are further based on our knowledge of facts as of the date hereof. We assume no duty to update or supplement our opinions to reflect any facts or circumstances that may thereafter come to our attention or to reflect any changes in any law that may thereafter occur or become effective. Moreover, our opinions are not a guarantee of result and are not binding on the Internal Revenue Service; rather, such opinions represent our legal judgment based upon our review of existing law that we deem relevant to such opinions and in reliance upon the representations and covenants referenced above.

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APPENDIX G

SPECIMEN MUNICIPAL BOND INSURANCE POLICY

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BAM

**MUNICIPAL BOND
INSURANCE POLICY**

ISSUER: [NAME OF ISSUER]

Policy No: _____

MEMBER: [NAME OF MEMBER]

BONDS: \$ _____ in aggregate principal
amount of [NAME OF TRANSACTION]
[and maturing on]

Effective Date: _____

Risk Premium: \$ _____
Member Surplus Contribution: \$ _____
Total Insurance Payment: \$ _____

BUILD AMERICA MUTUAL ASSURANCE COMPANY (“BAM”), for consideration received, hereby UNCONDITIONALLY AND IRREVOCABLY agrees to pay to the trustee (the “Trustee”) or paying agent (the “Paying Agent”) for the Bonds named above (as set forth in the documentation providing for the issuance and securing of the Bonds), for the benefit of the Owners or, at the election of BAM, directly to each Owner, subject only to the terms of this Policy (which includes each endorsement hereto), that portion of the principal of and interest on the Bonds that shall become Due for Payment but shall be unpaid by reason of Nonpayment by the Issuer.

On the later of the day on which such principal and interest becomes Due for Payment or the first Business Day following the Business Day on which BAM shall have received Notice of Nonpayment, BAM will disburse (but without duplication in the case of duplicate claims for the same Nonpayment) to or for the benefit of each Owner of the Bonds, the face amount of principal of and interest on the Bonds that is then Due for Payment but is then unpaid by reason of Nonpayment by the Issuer, but only upon receipt by BAM, in a form reasonably satisfactory to it, of (a) evidence of the Owner’s right to receive payment of such principal or interest then Due for Payment and (b) evidence, including any appropriate instruments of assignment, that all of the Owner’s rights with respect to payment of such principal or interest that is Due for Payment shall thereupon vest in BAM. A Notice of Nonpayment will be deemed received on a given Business Day if it is received prior to 1:00 p.m. (New York time) on such Business Day; otherwise, it will be deemed received on the next Business Day. If any Notice of Nonpayment received by BAM is incomplete, it shall be deemed not to have been received by BAM for purposes of the preceding sentence, and BAM shall promptly so advise the Trustee, Paying Agent or Owner, as appropriate, any of whom may submit an amended Notice of Nonpayment. Upon disbursement under this Policy in respect of a Bond and to the extent of such payment, BAM shall become the owner of such Bond, any appurtenant coupon to such Bond and right to receipt of payment of principal of or interest on such Bond and shall be fully subrogated to the rights of the Owner, including the Owner’s right to receive payments under such Bond. Payment by BAM either to the Trustee or Paying Agent for the benefit of the Owners, or directly to the Owners, on account of any Nonpayment shall discharge the obligation of BAM under this Policy with respect to said Nonpayment.

Except to the extent expressly modified by an endorsement hereto, the following terms shall have the meanings specified for all purposes of this Policy. “Business Day” means any day other than (a) a Saturday or Sunday or (b) a day on which banking institutions in the State of New York or the Insurer’s Fiscal Agent (as defined herein) are authorized or required by law or executive order to remain closed. “Due for Payment” means (a) when referring to the principal of a Bond, payable on the stated maturity date thereof or the date on which the same shall have been duly called for mandatory sinking fund redemption and does not refer to any earlier date on which payment is due by reason of call for redemption (other than by mandatory sinking fund redemption), acceleration or other advancement of maturity (unless BAM shall elect, in its sole discretion, to pay such principal due upon such acceleration together with any accrued interest to the date of acceleration) and (b) when referring to interest on a Bond, payable on the stated date for payment of interest. “Nonpayment” means, in respect of a Bond, the failure of the Issuer to have provided sufficient funds to the Trustee or, if there is no Trustee, to the Paying Agent for payment in full of all principal and interest that is Due for Payment on such Bond. “Nonpayment” shall also include, in respect of a Bond, any payment made to an Owner by or on behalf of the Issuer of principal or interest that is Due for Payment, which payment has been recovered from such Owner pursuant to the United States Bankruptcy Code in accordance with a final, nonappealable order of a court having competent jurisdiction. “Notice” means delivery to BAM of a notice of claim and certificate, by certified mail, email or telecopy as set forth on the attached Schedule or other acceptable electronic delivery, in a form satisfactory to BAM, from and signed by an Owner, the Trustee or the Paying Agent, which notice shall specify (a) the person or entity making the claim, (b) the Policy Number, (c) the claimed amount, (d) payment instructions and (e) the date such claimed amount becomes or became Due for Payment. “Owner” means, in respect of a Bond, the person or entity who, at the time of Nonpayment, is entitled under the terms of such Bond to payment thereof, except that “Owner” shall not include the Issuer, the Member or any other person or entity whose direct or indirect obligation constitutes the underlying security for the Bonds.

BAM may appoint a fiscal agent (the "Insurer's Fiscal Agent") for purposes of this Policy by giving written notice to the Trustee, the Paying Agent, the Member and the Issuer specifying the name and notice address of the Insurer's Fiscal Agent. From and after the date of receipt of such notice by the Trustee, the Paying Agent, the Member or the Issuer (a) copies of all notices required to be delivered to BAM pursuant to this Policy shall be simultaneously delivered to the Insurer's Fiscal Agent and to BAM and shall not be deemed received until received by both and (b) all payments required to be made by BAM under this Policy may be made directly by BAM or by the Insurer's Fiscal Agent on behalf of BAM. The Insurer's Fiscal Agent is the agent of BAM only, and the Insurer's Fiscal Agent shall in no event be liable to the Trustee, Paying Agent or any Owner for any act of the Insurer's Fiscal Agent or any failure of BAM to deposit or cause to be deposited sufficient funds to make payments due under this Policy.

To the fullest extent permitted by applicable law, BAM agrees not to assert, and hereby waives, only for the benefit of each Owner, all rights (whether by counterclaim, setoff or otherwise) and defenses (including, without limitation, the defense of fraud), whether acquired by subrogation, assignment or otherwise, to the extent that such rights and defenses may be available to BAM to avoid payment of its obligations under this Policy in accordance with the express provisions of this Policy. This Policy may not be canceled or revoked.

This Policy sets forth in full the undertaking of BAM and shall not be modified, altered or affected by any other agreement or instrument, including any modification or amendment thereto. Except to the extent expressly modified by an endorsement hereto, any premium paid in respect of this Policy is nonrefundable for any reason whatsoever, including payment, or provision being made for payment, of the Bonds prior to maturity. THIS POLICY IS NOT COVERED BY THE PROPERTY/CASUALTY INSURANCE SECURITY FUND SPECIFIED IN ARTICLE 76 OF THE NEW YORK INSURANCE LAW. THIS POLICY IS ISSUED WITHOUT CONTINGENT MUTUAL LIABILITY FOR ASSESSMENT.

In witness whereof, BUILD AMERICA MUTUAL ASSURANCE COMPANY has caused this Policy to be executed on its behalf by its Authorized Officer.

BUILD AMERICA MUTUAL ASSURANCE COMPANY

By: _____
Authorized Officer

SPECIMEN

Notices (Unless Otherwise Specified by BAM)

Email:

claims@buildamerica.com

Address:

1 World Financial Center, 27th floor

200 Liberty Street

New York, New York 10281

Telecopy:

212-962-1524 (attention: Claims)

SPECIMEN

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INVESTMENT BANKERS