CENTRAL ARIZONA PROJECT

CAP H2000

ANNUAL REPORT

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CENTRAL ARIZONA PROJECT
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TO OUR CUSTOMERS AND CONSTITUENTS:

For Central Arizona Project the year 2000 was a year of resolution.

Throughout the year CAP solved many critical issues — including reaching a financial settlement with the federal government, reducing the property tax we collect and lowering the cost of water to our customers – and still set record water deliveries of 1,540,312 acre-feet of water.

We are proud of the fact that it was the first time CAP exceeded its annual 1.5 million acre-foot allocation. We also are confident that meeting or exceeding our allocation will become routine as long as the water is available.

Along with record-setting water deliveries CAP also settled the long standing financial dispute with the federal government over our share of the reimbursable costs of building the 336-mile-long system of aqueducts, pumping plants, tunnels and siphons.

As a result of the settlement, the Central Arizona Water Conservation District Board of Directors lowered the property taxes we collect by 10 percent and reduced the rates that our customers pay for water by approximately 10 percent.

We also made internal improvements. We instituted a reserve study to help determine how much money we need to set aside each year to meet the required replacement costs of all CAP equipment.

We also have continued to work on replacing the impellers at Mark Wilmer Pumping Plant in Lake Havasu. This is the culmination of a 12-year effort to reduce the high noise levels and vibration caused by the impellers. We replaced one in 1999, two in 2000 and have three to go. The benefits to CAP are tremendous. The new impellers produce 23 percent more flow that can eventually enable us to pump more Colorado River water.

Perhaps one of the most important results of the settlement is that CAP is now able to focus on an enterprise-wide resource planning (ERP) system. The new ERP system will replace the existing computer programs used at CAP with one effective, integrated system that will be used by all employees. When it comes “on-line” in 2001, it will allow CAP and its people to work more effectively and efficiently.

CAP also continued to fulfill its water management responsibilities in 2000. We actively participated in helping to develop the rules and regulations that will govern interstate water banking between Arizona and Nevada. We also participated in developing an acceptable plan for California to reduce its over reliance on Colorado River water down to its 4.4 million acre-foot allocation.

Inside our borders, CAP created another recharge site in Pima County by bringing the Lower Santa Cruz River Recharge Project on-line and we continued to work on developing the Agua Fria Recharge Project in Maricopa County.

So it was a full year, a busy year, and a year of resolution.

But it also was a year of resolve for CAP. We resolve to be the state’s premiere water management agency. We resolve to hold true to CAP’s legacy that, as Arizona’s largest renewable water supplier, we will continue to bring the water needed to help sustain our quality of life in central and southern Arizona.

DS Wilson, Jr

DAVID S. “SID” WILSON JR. GENERAL MANAGER

CHAPTER 10

C H A L L E N G E S

For Central Arizona Project, 2000 was a year of resolution.

Businesses and organizations face problems and challenges that, at times, seem insurmountable. The resolution of those challenges, the way the problems are solved, determines the organization's legacy.

CAP's legacy is to provide water certainty in an arid state. CAP provides surety that today, tomorrow and into the future the people of Arizona will have a safe, dependable source of water. CAP holds to its legacy by annually delivering renewable water supplies from the Colorado River.

Creating that legacy was a long, difficult process. Transforming CAP from a mere dream at the beginning of the century to the reliable, dependable source of water it is today meant bringing a myriad of problems to resolution.

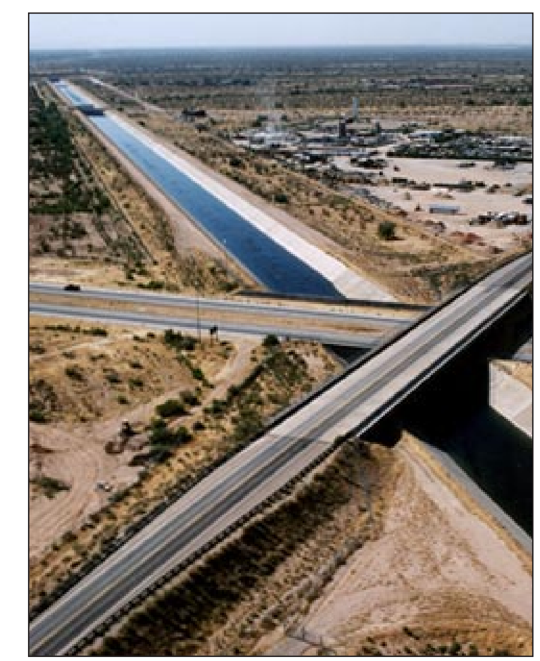
First, those who dared to envision the dream of CAP had to decide how to move the water from the river to the central and southern parts of the state. Many solutions were proposed, including one in the early 1900s that called for drilling a tunnel from the bottom of the Grand Canyon south to the vicinity of Camp Verde where the Colorado River water would be put into the Verde River. While that was never realized, there was, in time, a resolution to the problem: build an aqueduct from Lake Havasu and pump the water east to Phoenix and on to Tucson.

Once the physical form and route were decided, it was time to make the dream a reality.

Colorado River water is shared by seven states: Arizona, California, Colorado, Nevada, New Mexico, Utah and Wyoming. The states are divided into two Basins, Upper and Lower, and each Basin is entitled to 7.5 million acre-feet annually.

Arizona is part of the Lower Basin and shares the total of 7.5 million acre-feet annually with California and Nevada. Arizona is entitled to 2.8 million acre-feet, Nevada's share is 300,000 acre-feet and California gets 4.4 million acre-feet.

Politics has always played an important role in western water issues and became a major challenge when CAP was proposed. California, which uses far more than its 4.4-million acre-foot allocation because Arizona had no way to move the water to



THE CAP AQUEDUCT STRETCHES FROM LAKE HAVASU THROUGH THE PHOENIX AREA AND ON TO TUCSON.

Along with being "substantially complete," 1993 also brought CAP one of its longest running, most contentious problems.

the central part of the state, recognized the threat to its additional water and became a major CAP opponent. To remove the opposition, CAP accepted junior rights to the water. That means in times of drought, California is entitled to take its full 4.4-million acre-foot allotment before CAP takes any water.

With CAP's creation came new challenges. For example, the construction of Orme Dam, which was to serve as a storage and flood control reservoir for the Phoenix area, fell victim to environmental concerns. But, always flexible, always innovative, CAP managers and proponents reached a resolution by making Lake Pleasant the regulatory storage feature and the flood control functions were transferred to the already existing Roosevelt Dam.

Other problems arose only to be resolved with foresight and good management. In 1993, construction of the CAP water supply system was declared "substantially complete" by the Bureau of Reclamation (BOR), which built the 336-mile-long system. Though water deliveries began on a limited basis in 1985, water managers celebrated as CAP deliveries were now available to all customers in Pima, Pinal and Maricopa counties. Water was flowing from the Colorado River across the state, to the Valley of the Sun, through the farmlands of Pinal County to Tucson.

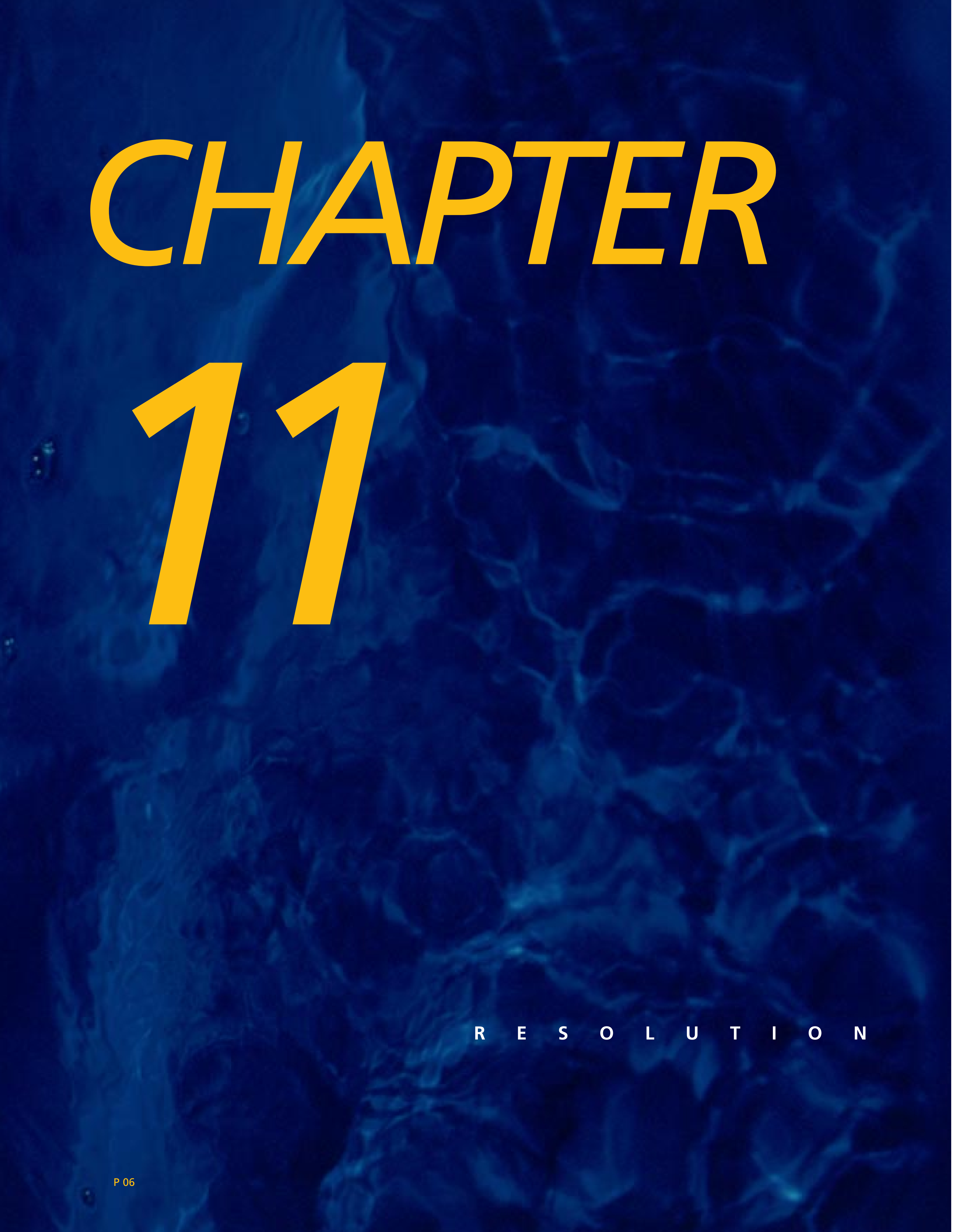
Along with being "substantially complete," 1993 also brought CAP one of its longest running, most contentious problems, the dispute with BOR over CAP's share of reimbursable costs for building the system. After years of negotiations and legal battles, there was a resolution to this challenge in 2000.

Although 2000 was a year of resolution for CAP, there is no end to CAP's resolve to find solutions to its many remaining challenges.

As it has in the past, CAP will work relentlessly to find solutions to help the state formulate and administer wise water policies, to participate in resolving regional disputes and to continue to provide Arizona with a safe, secure source of water now and into the future.

CALIFORNIA ORIGINALLY OPPOSED THE CONSTRUCTION OF CAP BECAUSE THE GOLDEN STATE USES MORE THAN ITS ANNUAL 4.4 MILLION ACRE-FOOT ALLOCATION.

LAKE PLEASANT IS CAP'S STORAGE RESERVOIR. FROM OCTOBER THROUGH MARCH, CAP PUTS WATER INTO THE LAKE AND FROM APRIL TO OCTOBER, WATER IS RELEASED FROM THE LAKE TO MEET THE INCREASED CUSTOMER DEMANDS.



CHAPTER 11

RESOLUTION

Evidence of CAP's careful planning and thorough preparation throughout 1999 became apparent as the year 2000 began at midnight without a bang, a whimper or even a sigh.

It was more like a yawn as the calendars clicked over with the second hand of the clock to begin the last year of the 20th Century and Y2K was a non-event. There were no computer failures, no failures of any kind. The only Y2K problem was lack of sleep as CAP employees remained on alert until the New Year's morning sun began to shine upon the water in the aqueduct.

With the passing of all Y2K concerns, CAP's Senior Management Team (SMT) turned its attention to successfully resolving many of the other on-going problems and disputes. By year's end, the hard work and dedication made 2000 a year of resolutions as CAP:

resolutions

1. Delivered in excess of 1.5 million acre-feet of water for the first time.
2. Reached a financial settlement with the United States over the reimbursable cost of the system.
3. Initiated a reserve study to plan for future repairs and needed replacements.
4. Began replacing impellers at the Mark Wilmer Pumping Plant at Lake Havasu.
5. Began its Enterprise Resource Planning project, an integrated information system.
6. Accelerated its plans for recharging water.
7. Participated in drafting regulations for Interstate Water Banking and began contract negotiations with Nevada and California.
8. Participated in key Colorado River issues, including supporting the implementation of California's 4.4 plan.

deliveries

CAP's first deliveries of Colorado River water began with water reaching the Harquahala Irrigation District in 1985 and Phoenix the following year. CAP did not exceed the 1-million acre-foot per year mark for water deliveries until 1996.

Just four years later, in 2000, CAP delivered a record 1,540,312 acre-feet of water for the year, an increase of 14 percent from the previous high of 1,364,715 set in 1997. One cubic foot of water is 7.48 gallons.

Dry weather was the primary reason for the record deliveries. When Arizona has a wet year, customers need less CAP water. Conversely, when it is dry, water orders increase.

Water year 2000 was the driest year on record for the local Salt and Verde rivers, managed by Salt River Project. The monsoon season was late and short, lasting only 51 days (normal is 86) and bringing only 1.21 inches of rain (normal is 2.78 inches). By comparison, in 1999 the monsoon lasted 84 days and brought 5.19 inches of rain.

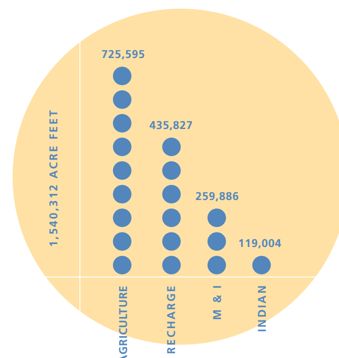
The resulting dry conditions in the summer of 2000 were so severe that the Salt River Project, faced with the specter of completely draining reservoirs such as Roosevelt to meet its customer demands, was forced to purchase more than 200,000 acre-feet of CAP water to augment its supply for its customers.

As a result, CAP had a record year. In addition to delivering a record 1,540,312 acre-feet of water, CAP also set records for daily and monthly water deliveries.

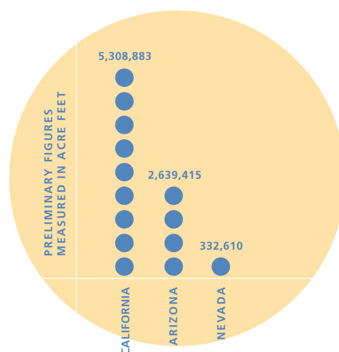
The old record for the most acre-feet of water delivered in one month — 197,945 in July of 1997 — was exceeded three times in 2000 when CAP reached 205,161 acre-feet in June, then 227,902 acre-feet in July and yet once more when 205,623 acre-feet were delivered in August.

CAP also surpassed the old record for the peak daily water delivery rate of 3,931 cubic feet per second (cfs) when it reached 4,065 cfs on July 18.

2000
CAP WATER DELIVERIES
HIGHEST RECORDED DELIVERIES



2000
LOWER BASIN WATER USE



NOTE: This tabulation is based on diversions including underground pumping, less measured return flow and less current AZ estimated unmeasured return flow to the river.

settl ement

After years of litigation and settlement discussions, negotiators for the Central Arizona Water Conservation District (CAWCD) and the United States agreed in May to settle a lawsuit over the reimbursable costs of building the CAP system.

Since CAWCD will be making a lower annual payment for its share of the costs without a reduction in revenues, the Board was able to reduce the tax and water rate.

The agreement settled a dispute that began in 1993 when the U.S. Bureau of Reclamation (BOR) declared the CAP water supply system to be substantially complete. Although there were many points of disagreement, the major one was that BOR claimed CAWCD's share of the construction cost was about $2.3 billion. CAWCD claimed its repayment obligation was limited by contract to $1.781 billion. CAWCD utilizes revenues from capital charges on CAP M&I (municipal and industrial) allocations, power revenues, a property tax levied in the three counties and interest on CAWCD reserves to meet its repayment obligation.

Negotiations between the two parties began in 1993. A tentative agreement was reached in 1995 but it fell apart at the last minute and CAWCD filed suit in U.S. District court. The complex trial was divided into several phases. Judge Earl Carroll ruled after the first phase in November 1998 that CAWCD owed no more than $1.781 billion.

Both sides continued to negotiate and, in 2000, managed to reach a resolution. The negotiated agreement, which conditionally ended the lawsuit, settled all the financial disputes between the U.S. and CAWCD.

The settlement fixes CAWCD's repayment obligation at $1.65 billion and gives the federal government an additional allotment of 200,000 acre-feet of water per year. In addition, CAWCD retains the exclusive right to market excess water. Excess water is any CAP water that is not taken by a customer with a long-term contract entitlement.

The agreement has several conditions subsequent, and one key condition states that within three years the state and federal government must settle Indian water rights disputes with the Gila River Indian Community and Tohono O'odham Nation. As part of that settlement, about 200,000 acre-feet of additional CAP water has been made available to the federal government to use to settle the claims. If the conditions aren't satisfied, litigation could resume.

As a result of the settlement, the CAWCD Board voted to reduce its property tax levy by 10 percent. The Board reduced the ad valorem tax rate for CAWCD from 10 cents to 9 cents per $100 of assessed valuation.

In addition, the Board reduced the capital cost of water to its municipal and industrial customers, which are cities and businesses, by about 10 percent, or $5 per acre-foot of water. That changed the capital cost component of water from $48 per acre-foot to $43 per acre-foot and meant a savings of $569,570 for Phoenix, $740,000 for Tucson, $70,000 for Glendale and $174,000 for Mesa.

The tax and water rate reduction was possible because the settlement reduced CAWCD's cost to $1.65 billion from the more than $2 billion claimed by the U.S. Since CAWCD will be making a lower annual payment for its share of the costs it could afford a reduction in revenues. Consequently, the Board was able to reduce the tax and water rate.

internal accomplishments

The financial settlement gives CAP financial certainty in a significant area of expense and capital debt. As a precautionary measure, CAP had maintained its financial reserves at optimum levels in case litigation resumes. However, with the settlement CAP is better able to project its costs more reliably, which will also enhance its ability to plan for the future.

One of the major steps CAP is taking is to conduct a reserve study. The study will show how much money is needed for future repairs and replacements and other purposes.

For example, a piece of equipment may have an expected life of 10 years and a projected replacement cost of $100,000. The reserve study would then project that CAP must either borrow the full replacement cost or set aside, or save, $10,000 a year so that in 10 years when the equipment wears out, the funds will be available to replace it.

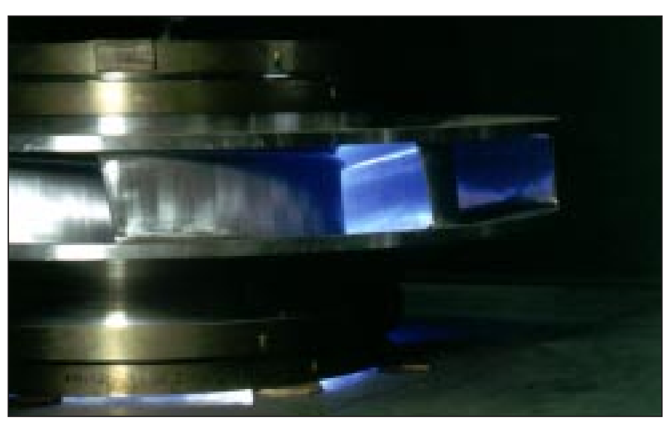
That study is being done on a system wide scale and will take into account all of CAP's equipment and expected future repairs. When complete, CAP will be able to project how much money to collect and set aside each year to meet the required replacement costs.

One major replacement project that continued through 2000 is the replacement of the six impellers at the Mark Wilmer Pumping Plant near Lake Havasu City. Impellers are used to push water 824 vertical feet up the side of a mountain. The water is then released into a seven mile long tunnel where it starts its journey through the CAP system.

About 12 years ago CAP began reviewing the high noise and vibration problem in the plant caused by the six impellers. Together with BOR, CAP undertook a study to review the situation and devised a replacement plan. The first impeller was replaced in 1999. In 2000 two more impellers, each costing about $350,000, were replaced. The fourth will be replaced in 2001 and the last two in 2002. The new impellers reduce the noise by a factor of three and vibration well over 80 percent.

In addition to reducing the noise and vibration, there has been an additional bonus to having the new impellers: each new unit at Mark Wilmer Pumping Plant will produce 23 percent more flow than it was originally designed to do and is more efficient in energy use. The extra flow will provide an incentive to CAP to upgrade other plants and the canal to accept the increased amount of water. Ultimately CAP will be able to pump more than the 3,000 cfs it now pulls out of the river.

In addition to the reserve study and impeller replacement, the settlement also has allowed CAP to focus on another mission "to specify, procure, and implement an



THE NEW IMPELLERS AT MARK WILMER PUMPING PLANT WILL INCREASE THE FLOW OF WATER BY 23 PERCENT.

The settlement also has allowed CAP to focus on another mission "to specify, procure, and implement an enterprise-wide resource planning (ERP) system to meet the needs of CAP for the first decade of the 21st century."

THE SYSTEM STARTS HERE: THE MARK WILMER PUMPING PLANT AT LAKE HAVASU IS THE BEGINNING OF THE 336-MILE-LONG SYSTEM.

enterprise-wide resource planning (ERP) system to meet the needs of CAP for the first decade of the 21st century."

The ERP project has required innumerable hours of research to determine the exact needs of groups and departments and to find one system that could share information. The proposed system would eliminate work redundancy and allow departments to share data by using one common computer platform. Although CAP initially sought a complete ERP system from a single vendor, a "best of breed" approach was adopted to more fully meet business needs. CAP selected two systems that will optimize CAP's current and future business processes. The new integrated system will replace the current financial system, the Maintenance Management System and manual processes in Human Resources.

ERP implementation began in October 2000 with building a project work plan, designing a communications strategy and assembling working teams for each functional area to assist with implementation. The expected "go live" date is September 2001.

recharge

While CAP focused on improving its internal technological structure it also moved in 2000 to position itself as Arizona's leading source of renewable water by opening a new recharge site, increasing Central Arizona Groundwater Replenishment District (CAGRD) membership and by participating in interstate water banking negotiations.

CAP protects Arizona against future water shortages by partnering with the Arizona Water Banking Authority (AWBA) and some customers to recharge excess CAP water. Recharge, or storing water underground for future use, is a kind of water bank. The water, stored in the underground aquifers, can be pumped back out during drought and, in the interim, the stored water replenishes already depleted aquifers.

In 2000, CAP added one more recharge site to its portfolio when it dedicated the Lower Santa Cruz Recharge Project (LSCRP) on November 2. About 30,000 acre-feet of Colorado River water will be recharged each year at LSCRP. LSCRP—a joint effort by CAP, Town of Marana, Pima County Flood Control District and BKW Farms—joined the Avra Valley Recharge Project (about 11,000 acre-feet per year) and Pima Mine Road Recharge Project (about 30,000 acre-feet per year), which are all located in the Tucson area.

CAP initially concentrated on locating recharge projects in Pima County because Tucson's groundwater table is falling dramatically as the city pumps more groundwater out of the aquifer than is replaced. This "groundwater mining" leads to problems including subsidence, or cracks in the earth, that can damage roads, homes and businesses. Recharge helps replenish the groundwater table and prevent subsidence.

Maricopa County is the site of CAP's next, and largest, planned recharge facility. The Agua Fria Recharge Project (AFRP) in Peoria continued to move forward in 2000. AFRP will be the first to include both in-stream and basin recharge systems. It is scheduled to begin operations in late 2001.

CAP also stepped up plans for more recharge sites in the state and is studying other sites in both eastern and western Maricopa County. CAP launched a Western Arizona Survey to find additional sites.

cagrd

Another way CAP improves its service to customers is through the Central Arizona Groundwater Replenishment District (CAGRD).

CAGRD helps customers and communities by providing a way for developers and water providers to demonstrate compliance with Arizona's requirement of a 100-year assured water supply using renewable water supplies rather than relying on groundwater. CAGRD enrolls members who cannot locate and secure enough renewable water supplies on their own to comply with the law. CAGRD replenishes groundwater on behalf of its members by recharging water to compensate for the excess pumping. Members are classified as Member Service Areas, such as cities, town and private water companies, and Member Lands, which primarily include subdivisions located outside city water service area boundaries.

In 1995 CAGRD began enrolling members and, by year's end, it had 4 Member Lands with 184 homes and 3 Member Service Areas, each representing a municipal water provider's service area. Since then, CAGRD has grown to 324 Member Lands, consisting of more than 70,000 homes and 15 Member Service Areas.

water banking

CAP has been a partner with the AWBA since it was created by the Arizona Legislature in 1996. The AWBA stores CAP water underground for future use.

Part of AWBA's funding comes from CAP which annually dedicates part of its ad valorem property tax to the Bank for the purchase and storage of excess or unused Colorado River water.

In 2000, CAP helped AWBA purchase and store more than 200,000 acre-feet of water that can be recovered in times of drought.

Through these efforts, and many others, CAP's leadership dedicated itself successfully to bringing to a resolution many of the issues facing CAP during the 20th Century.

THE LOWER SANTA CRUZ RECHARGE PROJECT, DEDICATED ON NOVEMBER 2, WILL RECHARGE ABOUT 30,000 ACRE-FEET OF WATER EACH YEAR.

CHAPTER 12

RESOLVE

The dawn of the 21st Century means CAP has moved from the resolution of past issues to strive to become Arizona's leading water management organization.

CAP resolves to continue dealing with internal changes while maintaining excellent customer service. At the same time, CAP is moving into a larger arena where it is dealing with statewide and regional issues.

As before, there seems to be no end to the challenges needing resolution. But the issues are critical and could affect Arizona's future water supply so CAP's board and management resolve to work diligently to find answers.

Some of the major challenges CAP faces in the new century are interstate water banking, helping to implement the Interim Operating Criteria for the Colorado River, dealing with the movement to drain Lake Powell, facing the Mexican Delta controversy, finding a way to implement the Multi-Species Conservation Program, and dealing with deregulation of the electrical industry in the desert Southwest.

Interstate water banking moved a step closer to becoming a reality in 2000. In conjunction with the Arizona Water Banking Authority (AWBA) and the Arizona Department of Water Resources (ADWR), CAP contributed to efforts to work with the U.S. to establish federal regulations to allow interstate water banking so Arizona could store water on behalf of Nevada and California. By the end of 2000 all parties had agreed to the new regulations.

In general terms, Nevada would pay all the costs of having the AWBA and CAP store Colorado River water in a recharge facility in Arizona. When Nevada wanted to reclaim the stored water it would take some of Arizona's allocation from the river and Arizona would then pump that same amount of water back out of the recharge site, put it back in CAP's aqueduct and deliver it to customers.

A second milestone negotiated in 2000 were the Interim Operating Criteria. CAP joined DWR and other Arizona water users in negotiations to develop criteria that would allow California to gradually reduce its use of Colorado River water to its 4.4-million acre-foot allotment. California currently uses an average of 5.2 million acre-feet of Colorado River water each year. The plan calls for California to receive a guarantee of at least 4.8 million acre-feet a year for 15 years while it works toward reaching its 4.4 goal.

THE COLORADO RIVER PROVIDES DRINKING WATER FOR MORE THAN 20 MILLION PEOPLE EACH DAY.

PHOTO BY PETER ENSENBERGER

LAKE POWELL STORES MORE THAN 25 MILLION ACRE-FEET OF WATER.

In simple terms, Arizona, Colorado, Nevada, New Mexico, Utah and Wyoming have agreed to guarantee California will receive 400,000 acre-feet more than its allotment for 15 years. Projections show there should be a natural surplus of river water available to accommodate California in most years. Surplus is declared on the river whenever the Colorado River storage system is relatively full and the projected runoff is more than can be safely stored.

However, the agreement states that in any year during that 15-year span, even if there is not a real or natural surplus, some water stored in Lake Mead will be released for California's benefit. The loss of stored water is expected to be recaptured over time in future surplus years.

CAP was concerned that if water is released from Lake Mead in consecutive years followed by a drought, a shortage would be declared on the river and CAP, as the junior right holder to Colorado River water, would be the first to lose its water.

The resolution to the problem: to protect CAP, California has agreed to take the first 1 million acre-feet of shortage if the extra water released for California during the 15 year span contributed to the shortage.

In December, outgoing Interior Secretary Bruce Babbitt praised the seven states for reaching agreement on the Interim Operating Criteria and promised it would be approved before President Clinton left office in January of 2001.

In addition to dealing with California, CAP also faces several regional environmental challenges as it seeks to manage Arizona's water supply.

The first of these is the movement to remove Glen Canyon Dam and drain Lake Powell. This movement, initiated by the Sierra Club in 1996, would threaten the reliability of CAP's water supply.

When full, Lake Powell stores more than 25 million acre-feet of water. Being such a formidable storage facility, Lake Powell helps stabilize the inconsistencies of the Colorado River. It allows the Upper Basin States to develop and use their full Colorado River apportionment while at the same time it assists them in meeting their long-term water supply commitments to the Lower Basin.

The importance of safeguarding the agreement between the upper and lower basins should not be underestimated. When Glen Canyon Dam was authorized in 1956 many water management issues were left unresolved. Without Glen Canyon Dam regulating the river, the seven states would be drawn into a series of legal disputes.

Draining Lake Powell would also have significant negative effects on CAP's main source of electricity, the Navajo Generating Station. Navajo gets its water supply from Lake Powell. If the lake were drained Navajo would need to find another water source or develop a new, more expensive pumping site.

Overall, draining Lake Powell would significantly impact the reliability of CAP's long term Colorado River water supply. Droughts on the Colorado River would cause more severe depletions of Lake Mead and draining Mead would eventually accelerate and increase water shortages to CAP and to Arizona.

Environmentalists claim draining Lake Powell would not only restore Glen Canyon's natural beauty, but it would also provide more water for the Mexican Delta. In most years very little river water reaches the Delta, where the Colorado River empties into the sea. The Delta is an environmentally sensitive area providing habitat to a variety of species.

Draining Lake Powell would significantly impact the reliability of CAP's long term Colorado River water supply.

Broad efforts have been underway for some time to determine the needs of the Delta and to propose solutions. The International Boundary and Water Commission (IBWC) has been working to establish a framework under which Mexico and the United States might cooperate in developing studies and recommendations for the area.

While it may seem easy to keep enough water in the river to restore the Delta habitat, there are many problems. Currently, BOR does not have the legal right to release Colorado River water except for river regulation, improvement of navigation and flood control; for irrigation and domestic uses; and for power. There is no law in place that would permit the release of water for environmental purposes.

In addition, if the water were released to Mexico for the Delta, there currently is no guarantee that such excess flows would ever get there. Mexico uses all of its Colorado River water and it's likely the excess would be diverted for agricultural and municipal use.

Yet another environmental issue facing CAP is the Lower Colorado River Multi-Species Conservation Program (MSCP). Through this program three states, along with numerous stakeholders including Indian tribes, wildlife agencies and water and hydroelectric power management agencies, are working together to achieve long-term compliance with state and federal endangered species laws.

This program is the first alliance of its kind to work toward protecting multiple species of threatened or endangered fish and wildlife

IF EXCESS COLORADO RIVER WATER WERE RELEASED TO MEXICO FOR THE DELTA, THERE CURRENTLY IS NO GUARANTEE THAT THE WATER WOULD NOT BE DIVERTED FOR AGRICULTURAL AND MUNICIPAL USE.

CAP IS PARTICIPATING IN A PROGRAM THAT IS WORKING TOWARD THE RECOVERY OF ENDANGERED SPECIES.

and their habitat. Its objectives are to accommodate current water diversions and power production and optimize future water and power development opportunities, while also conserving the habitat and working toward the recovery of endangered species and reducing the likelihood of additional threatened and endangered species listings.

The program covers the mainstem of the lower Colorado River from below Glen Canyon Dam to the International Boundary with Mexico, including the 100-year flood plain and full-pool reservoir elevations. It will include more than 100 species of mammals, birds, fish, amphibians, reptiles, invertebrates and plants as well as their associated habitats, ranging from aquatic, wetland, and riparian habitats to upland areas.

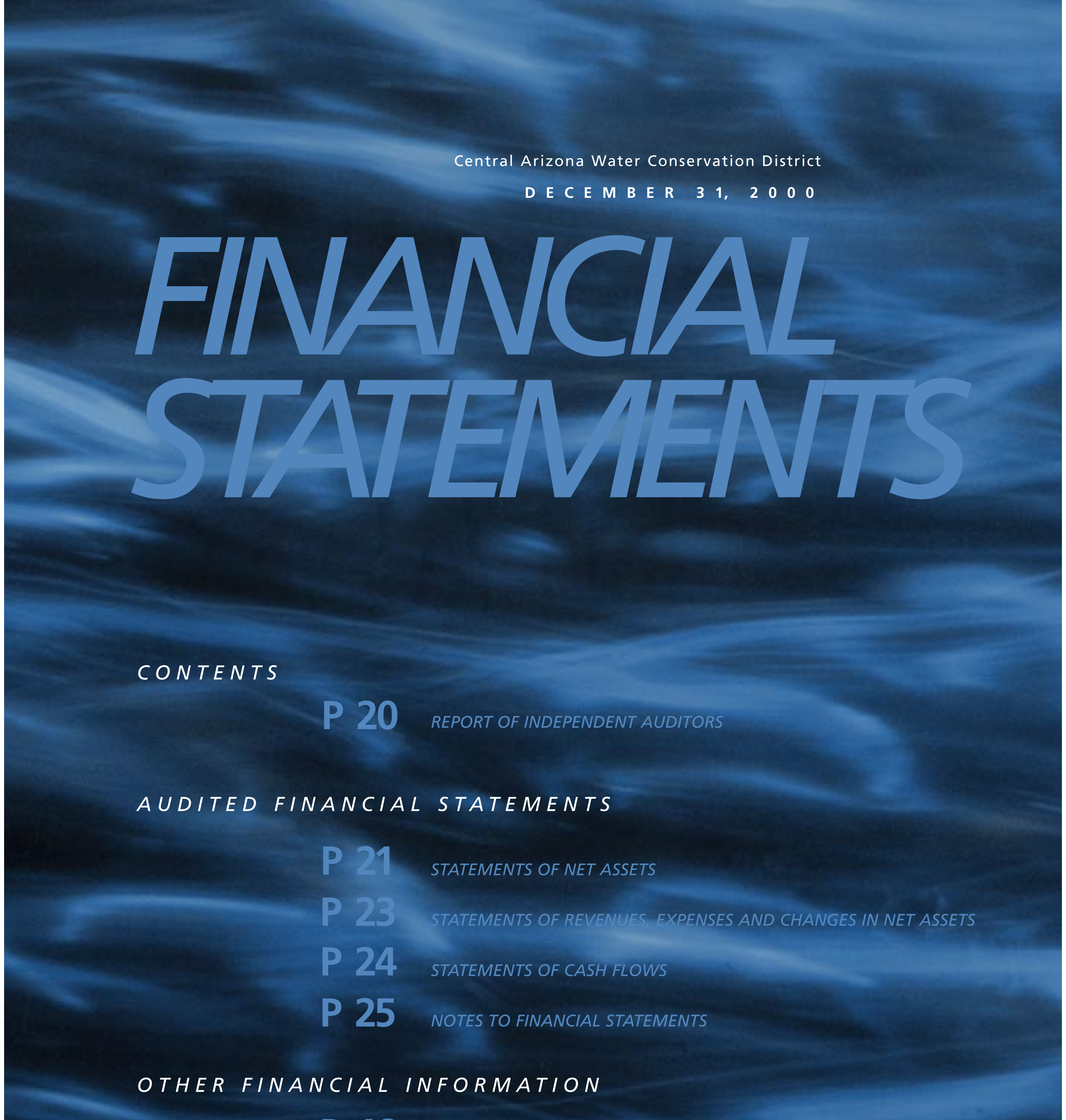
The MSCP began about five years ago, and it was estimated that program development would take about three to four years and cost about $4.5 million. Participants are now about five years into program development, and it is estimated that an additional two years and $2.2 million more will be needed to complete it, for a total cost of $6.7 million.

Once program development is complete the MSCP will be implemented over a 50 year period and will accommodate current water diversions and power production and optimize opportunities for future water and power development, while at the same time addressing the environmental needs as outlined by federal and non-federal agencies.

The move toward deregulating the electrical market began in earnest in 2000. In California, San Diego was among the first cities to experience increased power costs and rolling blackouts during the summer. Experts predicted California would experience more severe power shortages due to lack of generating capacity.

CAP did not experience any cost increases for power nor have any interruption of service. About 25 percent of the Navajo Generating Station is dedicated to CAP, along with some Hoover B and C power, which was enough to forestall any problems. Since CAP's transmission capacity contracts do not expire for more than a decade, the problems looming in the future caused by deregulation should have little, if any, negative impact on CAP.

CAP's leadership has resolved to deal with and help find solutions for these and many other challenges as it moves into the new century fully determined to secure and protect Arizona's water supply now and for generations to come.



Central Arizona Water Conservation District

DECEMBER 31, 2000

FINANCIAL STATEMENTS

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AUDITED FINANCIAL STATEMENTS

OTHER FINANCIAL INFORMATION

REPORT OF INDEPENDENT AUDITORS

The Board of Directors
Central Arizona Water Conservation District

We have audited the accompanying statements of net assets of Central Arizona Water Conservation District as of December 31, 2000 and 1999, and the related statements of revenues, expenses and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. 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 includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

The management's discussion and analysis beginning on page 48 is not a required part of the basis financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Central Arizona Water Conservation District at December 31, 2000 and 1999, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

March 16, 2001

Ernst & Young LLP

STATEMENTS OF NET ASSETS

	DECEMBER 31 2000	1999
ASSETS		*(In thousands)*
Current assets:		
Cash	**$ 38**	$ 2,639
Investment in Arizona Local Government Investment Pools	**5,896**	7,277
Total cash and cash equivalents	**5,934**	9,916
Receivables:		
Accrued interest receivable on unrestricted investments	**4,532**	1,589
Due from water customers, less allowance for doubtful accounts of $1,875 and $2,252 at December 31, 2000 and 1999, respectively	**1,866**	1,976
Other, less allowance for doubtful accounts of $-0- and $4,709 at December 31, 2000 and 1999 respectively	**669**	548
Repayment Credit *(Note 3)*	**35,584**	—
Materials and supplies inventory	**2,939**	2,727
Water Inventory	**12,647**	6,481
Other	**918**	1,735
Total current assets	**65,089**	24,972
Noncurrent assets:		
Funds held by federal government	**26,679**	27,789
Investment in State Treasurer CAP investment pool *(Note 6)*	**172,962**	173,477
Restricted assets *(Note 7)*	**98,740**	92,626
Advances to federal government *(Note 8)*	**5,930**	5,022
Property and equipment, less accumulated depreciation of $14,966 and $12,607 at December 31, 2000 and 1999, respectively	**23,192**	16,258
Permanent service right, less accumulated amortization of $208,851 and $178,313 at December 31, 2000 and 1999, respectively	**1,585,846**	1,761,190
Bond issuance costs, net of accumulated amortization of $2,726 and $2,480 at December 31, 2000 and 1999, respectively	**1,252**	1,512
Total noncurrent assets	**1,914,601**	2,077,874
Total assets	**$ 1,979,690**	$ 2,102,846

See accompanying notes.

STATEMENTS OF NET ASSETS CONTINUED

	DECEMBER 31 2000	1999
	(In thousands)	
LIABILITIES		
Current liabilities:		
Accounts payable	$ **12,901**	$ 13,897
Accrued payroll, payroll taxes and other accrued expenses	**4,479**	2,100
Current liabilities payable from restricted assets, advances to federal government, and other noncurrent assets:		
Accrued interest payable	**38,580**	42,758
Repayment obligation, due within one year *(Note 3)*	**20,272**	17,605
Contract revenue bonds, due within one year *(Note 10)*	**18,050**	17,250
OM&R reconciliation obligations *(Note 14)*	**16,240**	—
Total current liabilities	**110,522**	93,610
Noncurrent liabilities:		
Repayment obligation, due after one year *(Note 3)*	**1,526,013**	1,647,838
Contract revenue bonds, due after one year, net of unamortized discounts of $16,015 and $18,386 at December 31, 2000 and 1999, respectively *(Note 10)*	**171,768**	187,447
OM&R reconciliation obligation *(Note 14)*	—	18,000
Provision for retiree health insurance	**313**	—
Water operations and capital charges deferred revenue	**16,044**	16,301
Total noncurrent liabilities	**1,714,138**	1,869,586
Total liabilities	**1,824,660**	1,963,196
NET ASSETS		
Investment in capital assets, less related debt	**(125,812)**	(91,180)
Restricted	**96,465**	91,706
Unrestricted	**184,377**	139,124
Total net assets	**155,030**	139,650
Total liabilities and net assets	$ **1,979,690**	$ 2,102,846

See accompanying notes.

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

	YEAR ENDED DECEMBER 31 2000	1999
	(In thousands)	
OPERATING REVENUES		
Water operations and maintenance charges	$ **60,516**	$ 54,924
Water service capital charges	**28,283**	28,373
Power revenues *(Note 5)*	**51,553**	52,990
Reimbursements and other operating revenues	**3,729**	1,446
Total operating revenues	**144,061**	137,733
OPERATING EXPENSES		
Salaries and related costs	**27,933**	26,493
Pumping power	**44,564**	39,989
Power transmission	**1,922**	2,381
Hoover capacity charges	**3,072**	3,288
Amortization of permanent service right	**30,538**	32,835
Depreciation	**3,393**	2,725
Provision for OM&R reconciliation *(Note 14)*	—	2,000
Provision for doubtful accounts	**28**	419
Other operating expenses	**11,974**	10,252
Total operating expenses	**123,424**	120,382
Operating income before unusual expense item	**20,637**	17,351
Unusual expense item - provision for OM&R reconciliation *(Note 14)*	—	(16,000)
Operating income after unusual expense item	**20,637**	1,351
NONOPERATING REVENUES (EXPENSES)		
Property taxes, less assignment to Arizona Water Banking Authority of $9,967 and $9,125 in 2000 and 1999, respectively	**23,629**	22,754
Interest income and other nonoperating revenues	**19,526**	13,055
Interest income reserved for Ak-Chin fund	**336**	260
Interest income and other nonoperating revenues reserved for State Demonstration Project	**1,147**	1,029
Interest expense and other nonoperating expenses	**(49,895)**	(54,838)
Total nonoperating revenues (expenses)	**(5,257)**	(17,740)
Change in net assets	**15,380**	(16,389)
Net assets at beginning of year	**139,650**	156,039
Net assets at end of year	$ **155,030**	$ 139,650

See accompanying notes.

STATEMENTS OF CASH FLOWS

	2000	1999
	YEAR ENDED DECEMBER 31 (In thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from customers	**$ 90,429**	$ 83,250
Cash received from power sales	**54,090**	52,956
Cash paid to employees	**(25,554)**	(26,835)
Cash paid to suppliers	**(69,180)**	(57,268)
Net cash provided by operating activities	**49,785**	52,103
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Cash received from property taxes, net	**23,629**	22,754
Net cash provided by noncapital financing activities	**23,629**	22,754
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Payments on contract revenue bonds, including interest and other expenses	**(27,681)**	(27,672)
Payments on repayment obligation, including interest	**(58,616)**	(68,032)
Additions to property and equipment	**(10,327)**	(6,075)
Increase in Repayment Credit	**(35,584)**	—
Decrease in Repayment Obligation	**(101,553)**	—
Decrease in advances to federal government	**(908)**	(2,873)
Decrease in permanent service right	**144,806**	—
Net cash used in capital and related financing activities	**(89,863)**	(104,652)
CASH FLOWS FROM INVESTING ACTIVITIES		
(Increase) in restricted assets	**(6,114)**	(2,430)
Decrease in investment in state pool	**515**	12,943
Interest on investments	**18,066**	13,658
Net cash provided by investing activities	**12,467**	24,171
Net (decrease) in cash and cash equivalents	**(3,982)**	(5,624)
Cash and cash equivalents at beginning of year	**9,916**	15,540
Cash and cash equivalents at end of year	**$ 5,934**	$ 9,916
RECONCILIATION OF NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Net operating income (loss)	**$ 20,637**	$ 1,351
Adjustments to reconcile operating loss to net cash used in operating activities:		
Amortization of permanent service right	**30,538**	32,835
Depreciation	**3,393**	2,725
Provision for doubtful accounts	**28**	420
Changes in operating assets and liabilities:		
Due from water customers	**82**	(1,379)
Due from other receivables	**(121)**	65
Inventory	**(212)**	70
Lake Pleasant	**(6,166)**	(2,573)
Other	**817**	(884)
Funds held by federal government, net	**1,110**	1,413
Accounts payable	**(996)**	583
Increase (decrease) in deferred payment	**(257)**	(181)
OM&R reconciliation obligation	**(1,760)**	18,000
Accrued payroll, payroll taxes and other accrued expenses	**2,379**	(342)
Accrued pension	**313**	—
Net cash provided by operating activities	**$ 49,785**	$ 52,103

See accompanying notes.

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 2000

1. ORGANIZATION AND REPORTING ENTITY

The Central Arizona Water Conservation District (District) is a multicounty water conservation district organized within the state of Arizona encompassing Maricopa, Pima, and Pinal counties. The District's popularly elected Board of Directors serves as its governing body. Under the requirements of Governmental Accounting Standards Board (GASB) Statement No. 14, The Financial Reporting Entity, the District is a primary government, which includes an ancillary project, the Central Arizona Groundwater Replenishment District (CAGRD). The District was authorized in 1971 by the Arizona State Legislature for the primary purpose of creating a single entity to enter into an agreement (Note 3) with the United States Department of the Interior, Bureau of Reclamation (Reclamation), for repayment of the reimbursable cost of the Central Arizona Project (CAP). The District is further empowered to serve as the operating agent of the CAP.

In 1993, the State legislature gave the District additional authority to provide replenishment services within the District's three-county service area. This authority is commonly referred to as the Central Arizona Groundwater Replenishment District. The CAGRD began enrolling members in 1995, and as of December 31, 2000, there were 324 member lands (individual sub-divisions) and 15 member service areas. The CAGRD is responsible for using renewable water supplies to replenish (or recharge) excess groundwater used by its members. All costs of the CAGRD are to be paid by its members through assessments based on replenishment services provided. Through 2000, the CAGRD's total net replenishment obligation was approximately 3,456 acre-feet.

The CAP is a multi-purpose water resource project authorized by the Congress of the United States in 1968 by the Colorado River Basin Project Act and was constructed by Reclamation. The CAP is intended to deliver an average of approximately 1.5 million acre-feet of Arizona's annual share of Colorado River water to central and southern Arizona, which will partially replace existing groundwater uses and supplement surface water supplies. It also provides flood control, power, recreation, and fish and wildlife benefits. The major authorized project features include (1) a 335-mile aqueduct system (water supply system), (2) New Waddell and Modified Roosevelt Dams (regulatory storage facilities), (3) replacement features or programs for Cliff Dam (Cliff Dam Alternative), (4) Hooker Dam or suitable alternative (Hooker Dam Alternative), (5) Buttes Dam, (6) Navajo Power Project (Navajo), and (7) Indian and non-Indian water distribution systems.

The District has the authority to levy ad valorem taxes against all taxable property within its boundaries. The first ad valorem tax, which may not exceed 10 cents per $100 of assessed valuation, is for the District's operations and repayment of the construction cost repayment obligation of the CAP (Note 3). The second ad valorem tax, which may not exceed 4 cents per $100 of assessed valuation, is for water storage to the extent that it is not required for the District's operations or repayment of the construction cost repayment obligation of the project. Through December 1995, this tax was used to fund water recharge activities under State Demonstration Projects and was levied only in Maricopa and Pima Counties (see Note 7). In April 1996, the Arizona State Legislature amended the law relating to this second ad valorem tax (see Note 7). The ad valorem tax for operations and repayment was levied at 10 cents per $100 of assessed valuation for the tax year ending June 30, 2000, and 9 cents per $100 of assessed valuation for the tax year ending June 30, 2001. The ad valorem tax for water storage was levied at 4 cents per $100 of assessed valuation in 1999 and 2000 and has been transferred to the Arizona Water Banking Authority (see Note 7). Property taxes are collected on behalf of the District by the respective counties.

NOTES TO FINANCIAL STATEMENTS CONTINUED

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting

The accounting policies of the District conform to generally accepted accounting principles as applicable to an enterprise fund of a governmental unit. Accordingly, the accrual basis of accounting is utilized, whereby revenues are recorded when they are earned, and expenses are recorded when the liability is incurred. The District has elected, in accordance with GASB Statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Activities That Use Proprietary Fund Accounting, and GASB Statement No. 29, The Use of Not-for-Profit Accounting and Financial Reporting Principles by Governmental Entities, not to apply Financial Accounting Standards Board Statements and Interpretations issued after November 30, 1989. The District has elected to implement GASB Statement No. 34, Basic Financial Statements—and Management's Discussion and Analysis for State and Local Government, as well as GASB Statement No. 33, Accounting and Financial Reporting for Nonexchange Transactions, in 2000. The District's books and records include separate accounts and projects that are described as "funds": a general fund, Ak-Chin fund, State Demonstration Project fund, CAGRD project, and debt service funds. These "funds" have been combined in the accompanying financial statements. All material interfund transactions have been eliminated.

Use of Estimates

The preparation of financial statements that conform to 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. See also Note 3 and 11 regarding the District's repayment obligation and the Settlement Stipulation.

Cash and Unrestricted Investments

All funds are to be invested in obligations issued or guaranteed by the United States or any of its agencies, collateralized repurchase agreements, obligations of the state and local governments, prime quality commercial paper, and other instruments as set forth in the District's enabling legislation.

Investments are managed by the State Treasurer and maintained in investment pools (the CAP Pool, the state of Arizona Local Government Investment Pool and the state of Arizona Pool 3). The Local Government Investment Pool (LGIP) consists of investments with maturities of less than one year and therefore are recorded at cost. The CAP Pool and Pool 3 are recorded at fair value in accordance with GASB Statement No. 31, Accounting and Financial Reporting for Certain Investments and for External Investment Pools (see Note 6).

Inventory

Inventory is comprised of maintenance, office, auto, and safety supplies and is carried at the lower of cost (first-in, first-out) or market.

NOTES TO FINANCIAL STATEMENTS CONTINUED

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES CONTINUED

Property and Equipment

Property and equipment are stated at cost. Assets are depreciated on the straight-line method over the estimated useful lives of the assets ranging from five to forty years.

Permanent Service Right

The District's interest in the CAP represents a permanent service right pursuant to the Master Repayment Agreement and the settlement Stipulation (Note 3). The permanent service right represents the District's right to use the CAP water delivery system for the purpose of fulfilling its responsibility of delivering water as provided in the Master Repayment Agreement. The District has used the repayment obligation specified in the settlement Stipulation, plus certain advances to the federal government and other adjustments, in recording the permanent service right. The cost of the permanent service right may be adjusted in the future as a result of determinations to be made as a consequence of the settlement Stipulation (see Notes 3 and 11).

Although the District's interest in the CAP is reflected in the accompanying balance sheets, the United States retains a paramount right or claim in the CAP arising from the original construction and operation of the CAP as a Federal Reclamation Project. The District's right to the possession and use of, and to all revenues produced by, the CAP is evidenced by the Master Repayment Agreement, various laws, and other agreements with the United States. Legal title to the CAP will remain with the United States until otherwise provided by Congress.

The District amortizes the permanent service right on the straight-line method over the estimated useful lives of the major components of the CAP, generally 100 years for the aqueduct, 30 years for the Navajo power plant and related transmission facilities, 50 years for buildings and structures, and 20 years for the pumping plant equipment.

The cost of periodic maintenance is charged to operations expense and the cost of major replacements is capitalized.

Bond Issuance Costs and Discounts

Bond issuance costs and discounts are deferred and amortized over the term of the related bonds on the interest method. Bond discounts are presented as a reduction of the face amount of bonds payable whereas issuance costs are recorded as deferred charges.

Revenue Recognition

The District records revenue from the sale of water, the sale of power, the collection of property taxes and the provision of certain contract services to other outside entities. Water rates consist of a water service capital charge and an operations, maintenance and replacement (OM&R) charge (see Note 4). Generally, OM&R charges are determined by the Board of Directors after giving consideration to the amount of OM&R costs to be paid by the various subcontractors and through

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES CONTINUED

property taxes. Water is delivered to subcontractors and other customers based on delivery requests. Revenue from OM&R charges is recognized as it is earned and revenue from water service capital charges is recognized ratably over the period of the billing. Generally, OM&R charges for scheduled water deliveries are due in advance.

Revenues from contract services and the sale of power are recorded when earned.

Property taxes are recorded as revenue when received. Tax equivalency charges are recorded when received if there is no obligation to deliver any services or provision for refund.

Statement of Cash Flows

For the purpose of the statement of cash flows, investments in the state of Arizona Local Government Investment Pools are treated as cash equivalents due to their liquidity.

Water Inventory Adjustment

In 1998, the District adopted a new accounting policy for recording changes in the water inventory stored in Lake Pleasant. The water inventory adjustment is a means to adjust the pumping energy component of water service charges to recognize that the cost of power used to pump water into Lake Pleasant should be recovered, through OM&R charges, in the year the water is delivered to customers, not the year in which it is pumped into Lake Pleasant. Based on a typical operating year, which involves pumping water into Lake Pleasant between late October and April and releasing water from Lake Pleasant in June through early October, the expected amount of storage at year end is approximately 300,000 to 325,000 acre-feet. Since the District's share of Lake Pleasant storage at December 31, 1997 was approximately 324,000 acre-feet, this level was chosen as a base level storage from which future deviations would be measured. The value of the water storage inventory below 324,000 acre-feet was included in the permanent service right.

In 2000, the District further modified this policy to reclassify the water storage inventory below 324,000 acre-feet from the permanent service right to the water inventory adjustment. The amount of this adjustment was $9,790,000. The water inventory adjustment represents the weighted average energy cost associated with the change in storage level in Lake Pleasant over the calendar year. The District's share of Lake Pleasant storage as of December 31, 2000, was 359,000 acre-feet.

Application of GASB Statement No. 31

GASB Statement No. 31 changed the current practice of reporting most investments held by governmental entities from a cost basis to a fair value basis. At December 31, 1999, fair value exceeded cost by $986,000. At December 31, 2000, cost exceeded fair value by $317,000. These adjustments are included in interest revenue in the statements of operations and net assets.

Reclassification

Certain amounts in the 1999 financial statements have been reclassified to conform with the 2000 presentation.

3. MASTER REPAYMENT AGREEMENT

The Agreement

Reclamation and the District entered into a contract for delivery of water and repayment of costs of the CAP in December 1972 (1972 Master Repayment Agreement). The 1972 Master Repayment Agreement implemented the Colorado River Basin Project Act of 1968 (Project Act). Among other things, Reclamation agreed in the 1972 Master Repayment Agreement to construct the CAP and the District agreed to repay (1) the reimbursable construction costs of the CAP properly allocated to the municipal and industrial (M&I) and non-Indian agricultural water supply and the power functions of the CAP, (2) OM&R costs during construction properly allocated to the non-Indian water supply and power functions, and (3) interest during construction on costs allocated to the M&I water and the power functions. An amended contract (1988 Master Repayment Agreement) was executed in December 1988, which superseded and replaced the 1972 Master Repayment Agreement. (The 1972 Master Repayment Agreement as superseded and replaced by the 1988 Master Repayment Agreement is referred to herein as the Master Repayment Agreement.)

Commencement of Repayment

The Master Repayment Agreement provides that the Secretary of the Interior (Secretary) shall issue notice of completion of each CAP construction stage. Reclamation notified the District that the water supply system, the first construction stage, was substantially complete on October 1, 1993. This notification initiated repayment by the District for the water supply system. Reclamation notified the District that the regulatory storage facilities stage, consisting of New Waddell and Modified Roosevelt Dams, was substantially complete on September 30, 1996. This notification initiated repayment by the District for the regulatory storage facilities stage.

The Master Repayment Agreement requires the District to make annual payments to the United States on the repayment obligation related to the completed construction stages. These payments are required to be made over a 50-year period and are based on paying a percentage of the remaining outstanding repayment obligation, plus interest, with each construction stage having a separate 50-year repayment period as follows: contract years 1-7: 1 percent; 8-14: 1.3 percent; 15-21: 1.6 percent; 22-28: 2 percent; 29-35: 2.6 percent; and 36-50: 2.7 percent.

Repayment Litigation and Stipulation

In July 1995, the District filed a lawsuit against the United States seeking a judicial determination of the District's repayment obligation. The United States also filed a lawsuit against the District. The two lawsuits were consolidated into a single action in the Federal District Court (the Court) in Phoenix, Arizona (the Repayment Litigation). In May 2000, the District and the United States entered into a Stipulation Regarding a Stay of Litigation, Resolution of Issues During the Stay and for Ultimate Judgment upon the Satisfaction of Conditions (the Stipulation) to resolve all the issues in the Repayment Litigation. The Stipulation was approved by the Court on May 9, 2000.

The ultimate effectiveness of the Stipulation is subject to a number of conditions, including settlement of certain Indian water rights claims, and will require certain State of Arizona and federal legislation. If the conditions are not met within three years and the parties do not agree separately to amend the conditions or extend the deadline, the Stipulation will terminate

NOTES TO FINANCIAL STATEMENTS CONTINUED

MASTER REPAYMENT AGREEMENT CONTINUED

and litigation will resume. Either party may petition the Court to terminate the Stipulation and resume litigation before the deadline if it believes the conditions cannot be met by that date. Unless and until the Stipulation is terminated, it is effective as between the United States and the District. It is not possible to predict whether the Stipulation will become finally effective or if the litigation will resume or the outcome of any such litigation. If litigation resumes and results in an adverse determination on any of the major issues raised, it could have a material adverse effect on the financial operations of the District. The major issues addressed in the Stipulation are described below.

Repayment Obligation

The Stipulation establishes the District's repayment obligation for the CAP water supply system and the regulatory storage facilities at $1.65 billion, premised on a total allocation of 665,224 acre-feet of CAP water for federal use. Currently, 453,224 acre-feet of CAP water is allocated for federal use; one condition of the Stipulation is that additional CAP water be made available for federal use. The Stipulation provides that the $1.65 billion repayment obligation is subject to adjustment if the total amount of CAP water ultimately made available for Federal use is not 665,224 acre-feet.

In the Repayment Litigation, Reclamation had taken the position that the repayment ceiling in the Master Repayment Agreement on the District's repayment obligation for the water supply system and the regulatory storage facilities (Repayment Ceiling) was $2.0 billion. The District had argued that the Repayment Ceiling on these facilities was not more than $1.781 billion. Notwithstanding the Repayment Ceiling, Reclamation contended that the District's repayment obligation for these facilities was $2.183 billion, premised on a total allocation of 453,224 acre-feet of CAP water for federal use.

In November 1998, the Court issued an interlocutory order to the effect that the District's repayment obligation for the water supply system and regulatory storage facilities is limited to $1.781 billion. However, the United States appealed the Court order. After the Stipulation was entered, the appeal was voluntarily dismissed without prejudice. The Stipulation preserves the United States' appeal rights if the Repayment Litigation resumes.

Interest on Repayment Obligation

The Stipulation provides that 73 percent of the District's $1.65 billion repayment obligation will bear interest at the rate established in the Master Repayment Agreement of 3.342 percent per annum, and 27 percent of the repayment obligation will be non-interest bearing. The Stipulation fixes these percentages for the duration of the repayment period.

Before the Stipulation, the Master Repayment Agreement provided that Reclamation would perform a cost allocation that would then determine both the amount of the District's repayment obligation and the portion of that obligation that would bear interest. Costs allocated to the non-Indian agricultural water supply function were to be repaid by the District without interest, while costs allocated to the M&I water supply and the power functions were to be repaid with interest at 3.342 percent per annum. The Master Repayment Agreement also provided that Reclamation would periodically revise its cost allocation to reflect actual water deliveries, which could have the effect of altering the percentage of the District's repayment obligation that bears interest.

NOTES TO FINANCIAL STATEMENTS CONTINUED

MASTER REPAYMENT AGREEMENT CONTINUED

In the Repayment Litigation, the District disputed Reclamation's cost allocation. If the litigation resumes, the portion of the District's repayment obligation that bears interest would be subject to periodic revision by Reclamation based on its cost allocations.

Construction Deficiencies

When Reclamation issued notices of completion for the water supply system and regulatory storage facilities stages of the CAP, a number of construction deficiencies remained. The Stipulation provides that the construction deficiencies will be corrected without increasing the District's repayment obligation. The Stipulation identifies those deficiencies that will be corrected by the United States, at no additional cost to the District, and those that the District will correct itself and for which it will receive a corresponding credit against its annual repayment obligation. The Stipulation also provides a repayment credit for the District's past expenditures to correct construction deficiencies.

In the Repayment Litigation, the District had sought to hold the United States responsible for costs incurred by the District in correcting CAP construction deficiencies, which totaled $41,884,000 as of December 31, 2000. The United States had argued that it had no obligation to fund the correction of CAP construction deficiencies because of the dispute regarding the Repayment Ceiling and the fact that Reclamation had determined that the ceiling had been exceeded. The United States had also disclaimed any responsibility for costs incurred by the District in correcting those deficiencies.

Application of Development Fund Revenues

The Stipulation provides that all miscellaneous revenues and net power revenues accumulating in the Lower Colorado River Basin Development Fund (Development Fund) of the United States Treasury in each year will be credited annually against the amount due from the District on its repayment obligation.

In the Repayment Litigation, the United States had asserted that it was not obligated to apply Development Fund revenues toward the District's repayment obligation, but could use those revenues to pay Reclamation's operating costs.

Payments Due on the District's Repayment Obligation

The Stipulation establishes a new repayment schedule based on the revised $1.65 billion repayment obligation and reconciles the District's past payments, Development Fund credits and construction deficiency credits against that revised payment schedule.

The annual payments due from the District and the credits available from Development Fund revenues, construction deficiency corrections and other sources were among the issues in dispute in the Repayment Litigation. As of January 15, 2000, there was a difference of $118,903,000 between the amounts billed by the United States and the amount acknowledged by Reclamation to have been paid by the District on the District's repayment obligation. At that time, Reclamation was assessing penalties of approximately $1,189,000 per month against the District on the amounts in dispute.

MASTER REPAYMENT AGREEMENT CONTINUED

Amounts Recorded in Financial Statements

The repayment obligation and amounts due on that obligation reported in these financial statements reflect the terms of the Stipulation. If the credit amounts identified in the Stipulation are refined as a result of audit, there could be additional revisions to the amounts recorded in the financial statements. The District's repayment obligation and the amounts due could be adjusted in the future if the Repayment Litigation resumes.

Payments to Maturity

The required payments on the repayment obligation are the following:

	Principal	Interest	Total
2001	$ 20,272	$ 37,055	$ 57,277
2002	20,272	36,365	56,637
2003	20,272	35,724	55,996
2004	21,450	35,083	56,533
2005	21,450	34,403	55,853
Thereafter	1,442,569	579,355	2,021,924
Total	$ 1,546,285	$ 757,935	$ 2,304,220

NOTES TO FINANCIAL STATEMENTS CONTINUED

4. OPERATIONS

Operations and Maintenance Agreement

Reclamation has transferred responsibility for operation and maintenance of completed CAP features to the District. The District performs these responsibilities under the Master Repayment Agreement, a 1987 agreement with Reclamation for the operation and maintenance of the facilities (the OM&R Transfer Contract), and an Operating Agreement between Reclamation and the District that took effect as part of the Settlement Stipulation.

Water Delivery Contracts and Subcontracts

Long-term CAP water service began pursuant to contracts and subcontracts on October 1, 1993, upon issuance by the Secretary of notice of completion of the water supply system. The term of the contracts and subcontracts is generally 50 years beginning January 1, 1994, and the contracts and subcontracts are renewable.

Long-term subcontracts have been signed by M&I entities for approximately 87 percent of the total CAP M&I water allocation of 638,823 acre-feet. All ten Indian entities originally allocated CAP water by the Secretary have signed long-term CAP contracts for the CAP Indian water allocation of 309,828 acre-feet. An additional 355,396 acre-feet of CAP water has been or is expected to be allocated to Indian entities or treated as Indian water supplies as a result of completed, pending or future Indian water rights settlements. The remaining available CAP water was allocated to non-Indian agricultural entities. The cities of Tucson, Phoenix, Mesa, Scottsdale, Peoria and Glendale account for approximately 66 percent of the CAP water currently under M&I subcontracts.

The non-Indian subcontracts require the payment of a water service capital charge and an OM&R charge. For the M&I subcontractors, the water service capital charge is applicable to each subcontractor's maximum annual entitlement to CAP water. Under the current M&I water service subcontracts and current District pricing structure, the M&I water service capital charge is an escalating charge, beginning at an annual rate of $10.50 per acre-foot of entitlement in 1994 and increasing to $48 per acre-foot of entitlement by 1999. The M&I water service capital charge was $48 per acre-foot for 2000 and was reduced to $43 per acre-foot for 2001. The amount of this M&I water service capital charge may be adjusted periodically by the District as a result of repayment determinations provided for in the Master Repayment Agreement and to reflect all sources of revenue, but the water service capital charge will not be greater than necessary to amortize project capital costs allocated to the M&I function with interest. Indian contractors of CAP water pay no water service capital charge, since the capital costs associated with the delivery of CAP water to Indian entities are not reimbursable by the District pursuant to the Master Repayment Agreement.

The OM&R costs of the CAP are of two types: energy costs and fixed costs. Energy costs are incurred to pump water from the Colorado River through the CAP aqueduct system and fixed costs are the non-energy costs associated with operation and maintenance. The District is currently engaged in a cost of service study to better define what components properly constitute fixed OM&R costs.

M&I subcontractors and Indian contractors must pay OM&R charges on water scheduled for delivery.

NOTES TO FINANCIAL STATEMENTS CONTINUED

OPERATIONS CONTINUED

The District anticipates that Indian entities, or the United States on behalf of the Indian entities, will pay Indian fixed OM&R charges. Payment by the United States of Indian fixed OM&R charges would require annual appropriations by Congress or specific net billing arrangements that do not currently exist. The United States has paid OM&R charges on water delivered to the Ak-Chin Indian Community. Disputes that existed with respect to the amounts of those charges and the proper method of calculating OM&R charges were conditionally resolved as part of the settlement Stipulation.

District Repayment Plan

An important assumption in the development of the CAP was that non-Indian agricultural water users would take and pay for significant quantities of CAP water, particularly during the early years of project operation when M&I and Indian uses of CAP water were expected to be relatively low. The Secretary's allocation of CAP water, the physical configuration of the water delivery system, and the financial structure of the CAP were predicated upon such participation by non-Indian agricultural water users.

Long-term subcontracts for approximately 70 percent of the total non-Indian agricultural CAP water supply were signed. Two irrigation districts represented approximately 38.5 percent of that total. The non-Indian agricultural CAP subcontracts have been understood to require those subcontractors to pay fixed OM&R charges based on the full amount of CAP water available for delivery to the subcontractor, not just the amount scheduled for delivery (the take-or-pay OM&R charges), plus energy charges and a $2 per acre-foot water service capital charge for water scheduled for delivery. Many of the District's non-Indian agricultural subcontractors indicated that the take-or-pay requirement and the cost of CAP water would result in substantial reductions in CAP water use by the agricultural subcontractors and potential default by the subcontractors on their obligations under the subcontracts. Under the Master Repayment Agreement, prior to its modification by the Stipulation, diminished use of CAP water by non-Indian agricultural water users would also have increased the interest bearing portion of the District's repayment obligation and would have reduced the number of revenue sources available to meet the District's repayment obligation and to pay the OM&R costs of the CAP. Furthermore, OM&R costs would be allocated among fewer users, which would result in significantly higher per acre-foot charges to the remaining users.

As a result of these circumstances, the District's Board of Directors adopted a repayment adjustment plan in October 1993 (Plan). Under the Plan, each non-Indian agricultural subcontractor was provided the opportunity to waive its percentage entitlement to CAP agricultural water under its CAP subcontract and avoid its corresponding obligation for take-or-pay OM&R charges. As of December 31, 2000, all of the remaining non-Indian agricultural subcontractors had waived some or all of their long-term entitlements to CAP agricultural water under their CAP subcontracts. The District in turn waived its right to collect take-or-pay OM&R charges from such subcontractors.

Existing and former subcontractors of non-Indian agricultural CAP water were also given the opportunity by the District to enter into alternative contracts for the delivery of CAP water on a short-term basis. Under the Plan, the pool of CAP water available for delivery to non-Indian agricultural water users has been divided into various categories for purposes of determining water delivery priority and water service charges. Water service charges are assessed only on the amount of CAP water scheduled for delivery.

NOTES TO FINANCIAL STATEMENTS CONTINUED

OPERATIONS CONTINUED

As of December 31, 2000, nine existing and former subcontractors of agricultural CAP water had contracts with the District for the delivery of CAP water for agricultural purposes on these conditions. The contracts are for a ten year term, but are subject to (1) the availability of CAP water in each year after first providing for the delivery of water to contractors and subcontractors of long-term water service, including existing M&I subcontractors, Indian contractors and agricultural subcontractors who retained a percentage entitlement of CAP agricultural water under their CAP subcontracts, and (2) the determination by the District in each year of the water service charges. In the Repayment Litigation, the United States disputed the validity of these contracts. The Stipulation may require certain revisions to the form of these contracts, but otherwise confirms the District's right to sell CAP water under such alternative contracts. If the litigation resumes, the validity of these contracts will again be in issue.

In order to facilitate water planning, and subject to the assumptions contained in the Plan, the water service charges to be charged M&I subcontractors and the United States on behalf of Indian contractors of CAP water service were confirmed in 2000 by the Board of Directors of the District for the period 2001 through 2005. The District's Board of Directors reviews charges annually and sets a schedule for the succeeding five years. During 1997, the Board amended the Plan to provide for a computation of the M&I water service charge by dividing the District's estimated annual operating and energy costs by the total estimated annual water delivery volume.

If the District is unable to deliver the quantities of water to non-Indian agricultural users assumed in the Plan, OM&R costs allocated to M&I subcontractors and to the United States on behalf of Indian contractors could be significantly higher than anticipated. M&I subcontractors use CAP water in their total water supply in various percentages and fund their payment of the District's charges in a variety of ways. Therefore, it is difficult to estimate the effect of possible increases in the water service charges on M&I subcontractors and on retail ratepayers, if applicable, including households in the service areas of CAP M&I subcontractors.

The District cannot predict the extent to which any negative reaction toward its water service charges would be mitigated by considerations such as the essential nature of providing an assured long-term water supply and the availability (or lack thereof) of alternative water sources at competitive costs.

A failure of the District to receive payment of water service charges necessary to pay CAP OM&R costs, coupled with an inability of the District to mitigate the impact of such failure by other means, could have a material adverse effect on the District.

5. POWER

Navajo Power Plant

Reclamation is one of six participants in Navajo. Navajo consists of three 750,000 kilowatt coal-fired steam-electric generating units which commenced operations in 1974 through 1976, a railroad to deliver fuel and 500 kilowatt transmission lines and switching stations to deliver the power and energy to the various participants. An agreement among the participants governs the construction, operation, and maintenance of Navajo. Reclamation entered into this agreement in order to acquire a portion of the capacity of Navajo for supplying the power requirements of the CAP. Reclamation has a 24.3 percent entitlement in the generating station, resulting in a power entitlement of 547,000 kilowatts of nominal capacity. The District is charged for the costs associated with the energy used to operate the CAP.

NOTES TO FINANCIAL STATEMENTS CONTINUED

POWER CONTINUED

Hoover B Power Purchases

The 1984 Hoover Power Plant Act (Hoover Act) authorized upgrading the Hoover power plant, located at Hoover Dam, to increase generating capacity at the plant by 503 megawatts (MW). This additional capacity and its associated energy is known as Hoover B Power. The Hoover Act allocated 188 MW and 212,000 megawatt hours (MWh) of associated firm annual energy of the Hoover B Power to purchasers in Arizona. The Arizona Power Authority (Authority) distributes Arizona's share of the Hoover B Power. On September 15, 1986, the District entered into a contract with the Arizona Power Authority for the purchase of Hoover B Power. On October 1, 1992, the Authority recaptured all but 26.5 MW of Hoover B Power from its other contractors and initiated delivery of available Hoover B Power to the District.

Power Revenues

Power revenues are derived from the sale of surplus power from Navajo (power associated with Reclamation's Navajo entitlement which is in excess of the pumping requirements of the CAP) and from a surcharge on energy sold in Arizona from the Hoover power plant.

Additional Rate Component

The Hoover Act authorized the establishment and collection of additional rate components on sales and exchanges of the capacity and energy associated with Reclamation's Navajo entitlement in excess of the pumping requirements of the CAP and any needs for desalting and protective pumping facilities as may be required under the Colorado River Basin Salinity Control Act (Navajo surplus). The Hoover Act further authorized the payment of revenues from such additional rate components to entities that have advanced funds for the construction and repayment of construction costs of the CAP.

The Secretary determined that the excess capacity and energy, which constitutes Navajo surplus to be marketed pursuant to long-term contracts, is 400,000 kilowatts of capacity and 760 kilowatt hours of energy per year per kilowatt of such capacity. The District and Reclamation entered into power sales contracts with Salt River Project Agricultural Improvement and Power District (Salt River Project) in 1990 and 1991 for the sale of an aggregate of 350,000 kilowatts of such capacity and the associated energy from May 1993 through September 2011.

The additional rate component on the sale of such capacity has been established by the District at $6 per kilowatt of allocated capacity per month. Revenues from the additional rate component are paid directly to the District's bond trustee to repay the contract revenue bonds sold by the District (Note 10).

Sale of Remaining Navajo Surplus

In March 1994, the District entered into a contract with Salt River Project, Reclamation and the Department of Energy for the sale of the remaining Navajo surplus. The contract, which is for the period June 1994 through September 2011, grants Salt River Project the use of the remaining United States entitlement to output of the Navajo Generating Station, the right to schedule and integrate with the Salt River Project system the District's contractual (rights to Hoover capacity and energy) and to (energy produced at New Waddell Dam), and certain transmission rights, and requires Salt River Project to sell energy at cost to the District to meet CAP pumping requirements up to a defined threshold level for each contract year. If CAP energy

NOTES TO FINANCIAL STATEMENTS CONTINUED

POWER CONTINUED

requirements exceed the threshold, the District must purchase additional energy either from Salt River Project or through other energy sources. Under the contract, Salt River Project pays a monthly charge of $1,812,500 to the Development Fund. The District records these revenues as funds held by the federal government as of December 31 of each year and then applies them against the annual payment due from the District under the Master Repayment Agreement the following January 15. The extent to which such revenues must be applied against the annual payments due from the District under the Master Repayment Agreement is among the issues that were in dispute in the Repayment Litigation and were conditionally resolved in the Stipulation (Note 3).

Hoover Surcharge

The Hoover Act also provided for the addition of a surcharge to the rates for energy sold from the Hoover and Parker-Davis power plants of 4.5 mills per kilowatt-hour for energy sold in Arizona. Revenues from the surcharge on Hoover power sales began in 1987 and revenues from Parker-Davis power sales will begin in 2005. Revenues from this surcharge are credited to the Development Fund. The District records these revenues as funds held by the federal government as of December 31 of each year and then applies them against the annual payment due from the District the following January 15. The extent to which such revenues must be applied against the annual payments due from the District under the Master Repayment Agreement is among the issues that were in dispute in the Repayment Litigation and were conditionally resolved in the Stipulation (Note 3).

6. INVESTMENTS

As a multi-county water conservation district, the Arizona State Treasurer as prescribed by the District's enabling act holds the District's investments. Beginning March 1, 2000, the District's investments in the CAP pool were transferred to a shared investment pool (Pool 3) in order to eliminate the need for a separate pool just for the District. Since the investment policy objectives of the two pools are identical, the District does not anticipate any material impact on safety of principal, liquidity, or return on investment. The investment policy objectives of the Arizona State Treasurer, in order of priority, are safety of principal, liquidity, and return on investments.

Investments held by the CAP pool (as of December 31, 1999) and Pool 3 (as of December 31, 2000), which are categorized for the District, consist of the following stated at fair value:

	DECEMBER 31	
	2000	1999
	(In thousands)	
Federal Agency Securities	**$ 10,732**	$ 37,700
Commercial Paper	**32,716**	31,341
Corporate Securities	**165,891**	140,172
	209,339	209,213
Less restricted funds (repayment and operating reserves)	**(36,377)**	(31,615)
Less investment of state of Arizona	**—**	(4,121)
Investment of District	**$ 172,962**	$ 173,477

The Board of Directors has designated $86,700,000 of the Pool 3 investments as capital projects and operating reserve funds, and $2,000,000 as insurance reserves (see Note 11) at December 31, 2000.

NOTES TO FINANCIAL STATEMENTS CONTINUED

7. RESTRICTED ASSETS

Restricted assets, including accrued interest receivable, consist of the following:

	DECEMBER 31 2000	1999
	(In thousands)	
Bond trust funds, primarily debt service funds	$ 39,066	$ 37,008
State Demonstration Project fund	17,908	18,674
Master Repayment Agreement repayment and operating reserves	36,377	31,891
Ak-Chin fund	5,389	5,053
	$ 98,740	$ 92,626

Bond trust funds held by the trustee may be invested in direct obligations of, or obligations guaranteed by the U.S. government, FNMA or FHLMC securities, certificates of deposit, obligations of any state or political subdivision, or a guaranteed investment contract, all subject to meeting certain ratings by national agencies, and maximum maturity limits. The trustee holds the investments in trust for the District and the bondholders pursuant to the trust agreements.

Ak-Chin Fund

In August 1985, the District's Board of Directors approved participation in a fund established pursuant to legislation enacted by the Congress of the United States for the acquisition or conservation of water to supplement CAP water supplies (Ak-Chin fund). The District and the United States Government each have contributed $1,000,000 to this fund, which is administered by the District. The District, acting as administrator of the fund, is empowered to direct the expenditure of the trust funds in accordance with the provisions of a trust agreement between the District and the Arizona State Treasurer.

The Ak-Chin fund investment is in the LGIP, which invests primarily in certificates of deposit, commercial paper, federal government and federal agency securities. Investments in the LGIP are recorded at cost as they consist of investments with maturities of less than one year.

Repayment and Operating Reserves

The District is required under the terms of the Master Repayment Agreement to establish and fund over a ten-year period (1) an operations and maintenance reserve fund of $4,000,000 for extraordinary costs of operations, maintenance and replacement of project works, and (2) a repayment reserve fund of $40,000,000 for the purpose of assuring payments of future obligations. Funding of the operations and maintenance reserve fund and repayment reserve fund commenced on October 1, 1993 and July 1, 1993, respectively. At December 31, 2000, the fair value of the reserves totaled $3,321,000, and $33,005,000, respectively, including interest.

NOTES TO FINANCIAL STATEMENTS CONTINUED

RESTRICTED ASSETS CONTINUED

State Demonstration Projects

The Arizona Legislature passed the original State Demonstration Recharge legislation in 1990 that authorized the District to levy an ad valorem tax of 4 cents per $100 assessed valuation in Maricopa and Pima counties. Tax revenues collected through 1996 were deposited in the Arizona Water Storage Fund. Costs incurred by the District for planning and developing State Demonstration Recharge projects continue to be reimbursed from this fund.

The District is developing multiple State Demonstration Recharge Projects pursuant to its responsibilities under the 1990 legislation. During 2000, three recharge projects were operational, two projects were in the planning and design phase and two projects were undergoing feasibility study. State Demonstration Recharge Projects directly benefit the economy of the state of Arizona by storing currently unused CAP water underground to provide an additional source of water supply for future periods of shortage. Municipal water providers, the Central Arizona Groundwater Replenishment District and the Arizona Water Banking Authority contract with the District to purchase and store water at the recharge projects.

Arizona Water Banking Authority

In April 1996, the State Demonstration Project statute was amended by the Arizona Legislature. The amended statute created the Arizona Water Banking Authority (AWBA) for the purpose of increasing the utilization of Arizona's allocation of Colorado River water by delivering excess CAP water to various groundwater recharge projects through the CAP canal system. The amended statute expanded the District's ad valorem taxing authority to include Pinal County in addition to Maricopa and Pima counties and created the Arizona Water Banking Fund. The amended statute directs the District to transfer revenues derived from this tax to the Arizona Water Banking Fund to fund AWBA activities if the District's Board of Directors approves the levy and concludes that the revenues are not needed for CAP operations or CAP repayment. Pursuant to this authority, the District levied an ad valorem tax of 4 cents per $100 assessed valuation in Maricopa, Pinal, and Pima counties in 1999 and 2000 and approved the transfer of these revenues to the Arizona Water Banking Fund (Note 1). During 2000 and 1999, the District sold 293,576 and 251,943 acre-feet of excess CAP water to the AWBA at $44 and $43 per acre-foot, respectively, for underground storage.

8. ADVANCES TO FEDERAL GOVERNMENT

At December 31, 2000 and 1999, the District has incurred $5,930,000 and $5,022,000 in costs related to repairs of CAP construction deficiencies which have been recorded in the accompanying financial statements as advances to the federal government. The District applied these amounts against its annual payments due under the Master Repayment Agreement on January 15, 2001 and 2000, respectively. On a cumulative basis, the District has incurred costs of $41,884,000 for the correction of CAP construction deficiencies and applied this amount against its annual payments under the Master Repayment Agreement. Under the Stipulation, credits available for application against the amounts due from the District are subject to audit by the United States (see Note 3).

NOTES TO FINANCIAL STATEMENTS CONTINUED

9. UNDERGROUND WATER STORAGE AND RECOVERY

In 1992, the District entered into an agreement with the Metropolitan Water District of Southern California (MWD) and subsequently with Southern Nevada Water Authority (SNWA), whereby up to an aggregate of 100,000 acre-feet of interstate underground water storage credits would be set aside for potential assignment to MWD and SNWA if the Secretary declares a surplus of Colorado River water. Once assigned, MWD and SNWA can recover these credits in years in which the Secretary has declared a normal supply of Colorado River water. The water will be delivered through exchange of the interstate underground water storage credits back to the District for diversion of water from the Colorado River by MWD and SNWA. The District must reduce its maximum level of diversions from the Colorado River equal to the amount diverted by MWD and SNWA. In 1995, an amendatory agreement was executed between the District and MWD increasing the amount of water that can be stored from 100,000 acre-feet to 300,000 acre-feet of water and the time for placing the water into storage from December 31, 1996 to December 31, 2000. As of December 31, 1995, the District had received $11,386,000 related to 139,000 acre-feet that was recorded as a reduction in the costs capitalized in connection with the underground water storage projects. As of December 31, 1998, all of the 139,000 acre-feet of underground storage credits were assigned to MWD (89,000 acre-feet) or SNWA (50,000 acre-feet). MWD and SNWA can recover these credits in future years in which the Secretary declares a normal supply of Colorado River water. When this occurs, the District would reduce its diversions from the Lower Colorado River by the amount of credits being recovered and execute a plan to recover and deliver an equal volume of stored credits in lieu of Colorado River water that would have been pumped.

On November 1, 1999, the Secretary of the Interior adopted a final rule entitled Offstream Storage of Colorado River Water and Development of Intentionally Created Unused Apportionment in the Lower Division States. These regulations became effective on December 1, 1999, and authorized the AWBA to engage in interstate banking of Colorado River water in cooperation with other states of the Lower Division. An agreement is being developed which allows the District to intentionally create unused apportionment for the specific purpose of facilitating interstate banking of Colorado River water in Arizona by Nevada and California. Interstate banking agreements are also being developed with these states.

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NOTES TO FINANCIAL STATEMENTS CONTINUED

10. BONDS PAYABLE

Bonds payable consist of the following:

	DECEMBER 31	
	2000	1999
	(In thousands)	
Central Arizona Water Conservation District (Central Arizona Project) Contract Revenue Bonds, Series A 1990 (1990 Bonds) (original maturity amount of $71,895,000, excluding 1990 Bonds which have been refunded), due in varying annual amounts through 2011; interest rates vary among individual maturities ranging from 6.90 percent to 7.40 percent		
Serial	**$ 9,985**	$ 14,215
Special term	**8,305**	11,244
Capital appreciation (maturity value of $11,760,000)	**7,230**	6,733
	25,520	32,192
Central Arizona Water Conservation District (Central Arizona Project) Contract Revenue Bonds, Series B 1991 (1991 Bonds) (original maturity amount of $80,045,000, excluding 1991 Bonds which have been refunded), due in varying amounts through 2011; interest rates vary among individual maturities ranging from 5.80 percent to 6.80 percent		
Serial	**20,701**	26,793
Term	**109**	109
Capital appreciation (maturity value of $23,095,000)	**17,072**	15,979
	37,882	42,881
Central Arizona Water Conservation District (Central Arizona Project) Contract Revenue Refunding Bonds, Series A 1993 (1993 Bonds) (original maturity amount of $106,535,000), due in varying annual amounts through 2010; interest rates vary among individual maturities ranging from 4.05 percent to 5.50 percent	**92,327**	94,096
Central Arizona Water Conservation District (Central Arizona Project) Contract Revenue Refunding Bonds, Series B 1994 (1994 Bonds) (original maturity amount of $53,430,000), due in varying amounts through 2009; interest rates vary among individual maturities ranging from 3.50 percent to 4.75 percent		
Serial	**32,408**	33,859
Subordinate serial	**5,812**	6,347
Deferred loss on refunding	**(4,126)**	(4,678)
	34,094	35,528
	189,818	204,697
Less current portion	**(18,050)**	(17,250)
	$ 171,768	$ 187,447

NOTES TO FINANCIAL STATEMENTS CONTINUED

BONDS PAYABLE CONTINUED

Changes in bonds payable during the year ended December 31, 2000, are summarized below:

	BALANCE DECEMBER 31 1999	REDEMPTION	ACCRETION AND AMORTIZATION	BALANCE DECEMBER 31 2000	AMOUNTS DUE WITHIN ONE YEAR
			(In thousands)		
1990 Bonds					
Serial	$ 14,215	$ 4,230	$ —	$ 9,985	$ 7,710
Special term	11,244	3,000	61	8,305	—
Capital appreciation	6,733	—	497	7,230	—
1991 Bonds					
Serial	26,793	6,110	18	20,701	6,490
Term	109	—	—	109	—
Capital appreciation	15,979	—	1,093	17,072	—
1993 Bonds	94,096	1,845	76	92,327	1,750
1994 Bonds					
Serial	33,859	1,525	69	32,403	1,595
Subordinate serial	6,347	540	5	5,812	505
Deferred loss	(4,678)	—	552	(4,126)	—
	$ 204,697	$ 17,250	$ 2,371	$ 189,818	$ 18,050

The 1990 Bonds and 1993 Bonds are secured by a pledge of revenues, and related interest thereon, from the additional rate component charged by the District to the Salt River Project on the sale of 200 MW of allocated capacity of surplus power associated with Reclamation's 24.3 percent entitlement in Navajo. The 1991 Bonds and 1994 Bonds are secured by a similar pledge of revenues from the additional rate component charged Salt River Project on the sale of an additional 150 MW of allocated Navajo capacity (Note 5).

The 1990 and 1991 Capital Appreciation Bonds and 1993 Bonds are noncallable. The remaining 1990 and 1991 bonds are subject to optional redemption commencing in 2000 at a price of 102 percent with a declining price to par in 2003, except for $2,500,000 of the special term bonds due in 2011, which are redeemable at par after 2000. The 1994 Bonds are subject to optional redemption commencing in 2004 at a price of 102 percent with a declining price to par in 2006.

The 1990 Special Term Bonds aggregating $2,500,000 and the 1991 Term Bonds are subject to sinking fund requirements and mandatory redemption equal to the amount of any unsatisfied portion of the sinking fund requirement.

NOTES TO FINANCIAL STATEMENTS CONTINUED

BONDS PAYABLE CONTINUED

Debt service requirements to maturity, which include the sinking fund requirement and interest of $49,556,000 are as follows: Years ending 2001: $27,374,000; 2002: $27,321,000; 2003: $27,321,000; 2004: $27,321,000; 2005-2006: $54,642,000; 2007-2011: $91,411,000.

In April 1993 and February 1994, the District refinanced through advanced refunding arrangements approximately $89,545,000 and $44,525,000 of outstanding 1990 bonds and 1991 bonds, respectively. The net proceeds were used to purchase U.S. Government securities. Those securities were deposited in an irrevocable trust to provide for all future debt service payments on the refunded 1990 Bonds and 1991 Bonds. As a result, the refunded 1990 Bonds and 1991 Bonds are considered to be defeased and the liability for those bonds of $134,070,000 at December 31, 2000 has been removed from the balance sheet.

The District has deferred the accounting loss of $8,109,000 related to the 1991 bonds. The accounting loss is amortized to income on the interest method over the life of the new bonds.

11. COMMITMENTS AND CONTINGENCIES

Insurance Reserve

The District's Board of Directors has designated $2,000,000 of noncurrent unrestricted investments to act as a reserve for property and liability damages to be available to respond to any claims, judgments, and related costs against the District, its officers, directors, and employees, if any, in excess of the outstanding insurance coverage.

Litigation

The District is a party to certain litigation and other proceedings that could have the effect of increasing the District's costs or reducing or eliminating certain sources of revenues available to the District to meet those costs. The most significant of these is the Repayment Litigation with the United States, in the event that the conditions to the Stipulation are not satisfied, or if the Stipulation terminates and litigation resumes for any other reason (Note 3).

12. PENSION PLANS

Retirement benefits are provided to District employees through two separate plans as of December 31, 2000. Benefits were provided for service prior to July 1, 1998, through the Central Arizona Water Conservation District Retirement Plan (the District Plan) and from July 1, 1998 through December 31, 2000, through the Arizona State Retirement System. Employees retired or terminated prior to July 1, 1998, or their beneficiaries, continue to be provided benefits through the Central Arizona Water Conservation District Retirement Plan.

NOTES TO FINANCIAL STATEMENTS CONTINUED

PENSION PLANS CONTINUED

Central Arizona Water Conservation District Retirement Plan

The District maintains the Central Arizona Water Conservation District Retirement Plan, a single-employer defined benefit pension plan covering substantially all of its employees who retired or terminated prior to July 1, 1998.

The District's Board of Directors amended the District Plan on May 7, 1998, providing certain changes in benefits. The amendment provides that active employees as of June 30, 1998, are eligible to participate in the District Plan as of their date of employment. No credited service is earned or credited for any period of employment after July 7, 1998. Upon normal retirement date, participants are entitled to a retirement income equal to 2 percent of their average monthly compensation multiplied by years of service. Average monthly compensation is the average of monthly compensation during the 36 consecutive-month period within the last 120-month period of service that yields the highest average. The change in the present value of accumulated benefits as a result of these amendments totaled $5,014,114 at December 31, 1998. There were no amendments in 1999 or 2000.

All active employees of the District Plan were given the option to transfer their accounts from the District Plan to the Arizona State Retirement System Plan as of July 1, 1998. All active employees elected to transfer their accounts to the Arizona State Retirement System Plan. Accordingly, funds in the amount of $18,581,000 were transferred from the District Plan to the Arizona State Retirement System Plan in February 1999.

The District Plan also offers certain early retirement options and death benefits. These benefit provisions and all other requirements are established by the District's Board of Directors. The District Plan does not issue a stand-alone financial report.

As of December 31, 2000, there were 97 participants in the District Plan. There were 19 retirees and beneficiaries receiving benefits and 53 terminated members and beneficiaries entitled to, but not yet receiving benefits.

The net pension benefit obligation and annual pension cost were computed as part of an actuarial valuation performed as of January 1, 2000, the beginning of the District Plan's year. The District Plan's pension liability was determined in accordance with the provisions of Governmental Accounting Standards Board Statement No. 27. Significant actuarial assumptions used in the valuation include a rate of return on the investment of present and future assets of 6.5 percent a year compounded annually, and projected salary increases of 4.0 percent a year compounded annually. In previous years, the District's liability was calculated as of the end of each plan year. Beginning in 1999, the liability is calculated looking forward at the beginning of each plan year.

The District's funding policy provides for an actuarially determined contribution within the range of contributions as specified under the Internal Revenue Code. The contribution for normal cost is determined using the entry-age normal cost method. The District uses the level percentage of payroll method to amortize the unfunded liability. Beginning in 1998, the District elected to change the amortization period for the unfunded liability from 30 to 15 years.

NOTES TO FINANCIAL STATEMENTS CONTINUED

12. PENSION PLANS CONTINUED

The annual pension cost and net pension obligation for 2000 are as follows:

Annual required contribution for 2000	$ 63,978
Adjustment to annual required contribution	559
Annual pension cost	64,537
Contributions made for 2000	(63,978)
Increase in net pension obligation	559
Net pension obligation, beginning of year	(12,643)
Net pension obligation, end of year	$ (12,084)

The significant actuarial assumptions used to compute the actuarially determined contribution requirement are the same as those used to compute the pension benefit obligation. Contributions to the District Plan for the years ended December 31, 2000 and 1999, were approximately $64,000 and $72,000, respectively, each of which was made in accordance with actuarially determined requirements. The District records the actuarially determined contributions for the Plan year as an expense in the corresponding year.

Trend information for the District Plan years ended December 31, 1997 through 2000 is as follows:

YEAR ENDING	ANNUAL PENSION COST	AMOUNT CONTRIBUTED	PERCENTAGE OF ANNUAL PENSION COST CONTRIBUTED	NET PENSION OBLIGATION
December 31, 1997	$ 1,720,578	$ 1,718,833	99.9 %	$ (13,633)
December 31, 1998	629,941	629,466	99.9	(13,158)
December 31, 1999	72,564	72,049	99.3	(12,643)
December 31, 2000	64,537	63,978	99.1	(12,084)

The actuarial value of the District Plan assets and actuarial accrued liabilities for plan years ended December 31, 1997 through 2000 are as follows:

VALUATION DATE	ACTUARIAL VALUE OF ASSETS	ACTUARIAL ACCRUED LIABILITY	UNFUNDED ACTUARIAL ACCRUED LIABILITY	ACTUARIAL VALUE OF ASSETS AS PERCENTAGE ACTUARIAL ACCRUED LIABILITY	ANNUAL COVERED PAYROLL	UNFUNDED ACTUARIAL ACCRUED OF LIABILITY AS PERCENTAGE OF ANNUAL COVERED PAYROLL
December 31, 1997	$ 16,322,894	$ 17,951,007	$ 1,628,113	90.93%	$ 18,221,264	8.94%
December 31, 1998	20,407,198	26,710,573	6,303,375	76.40	19,846,370	31.76
January 1, 1999	21,036,664	21,686,104	649,440	97.01	19,470,069	3.34
January 1, 2000	2,687,777	3,237,970	550,193	83.01	221,649*	248.23*

** During 1999, all but 4 active participants elected to forfeit all benefits under this plan in exchange for receiving credited service in the Arizona State Retirement System for service accrued through June 1998 in this plan. The majority of remaining liabilities under this plan is for inactive participants.*

NOTES TO FINANCIAL STATEMENTS CONTINUED

PENSION PLANS CONTINUED

The actuarial value of assets represents the market value as determined by the District Plan trustee. Investments with the Federal Home Loan Mortgage Corporation exceed 5 percent of total investments.

Arizona State Retirement System Plan

Effective July 1, 1998, the District became a member of the Arizona State Retirement System (ASRS), a cost-sharing, multiple-employer, public employee retirement system established by the State of Arizona to provide benefits for employees of the State and participating political subdivisions and school districts. The ASRS Board administers the Arizona State Retirement System Plan (ASRS Plan), which is a defined benefit pension plan. The ASRS Plan provides for retirement, disability, health insurance premium benefits, and death and survivor benefits as established by State statute. Substantially all employees of the District are covered by the ASRS Plan.

The ASRS Plan issues a Comprehensive Annual Financial Report, including financial statements and supplemental information, which may be obtained by writing to Arizona State Retirement System, 3300 North Central Avenue, P.O. Box 33910, Phoenix Arizona 85067-3910 or by calling (602) 240-2000 or 1-800-621-3778.

The Arizona Revised Statutes provide statutory authority for determining the employees' and employers' contribution amounts as a percentage of covered payroll. Employers are required to contribute at the same rate as employees. The employee and employer contribution rates for the ASRS Plan year ending June 30, 1999 were set at 3.34 percent, and for the Plan years ending June 30, 2000 and June 30, 2001, were set at 2.66 percent of covered wages as determined by an actuarial computation based on June 30, 1998 information. Contributions for 2000, 1999, and 1998, were $1,252,933, $1,411,536, and $695,054, respectively, for both employees and the District. The District pays both the employee and employer portions of the contribution.

Post Employment Benefit Plan

The District provides post employment health care benefits to employees who are eligible for monthly retirement benefits under the pension plan and who have received coverage under the District's group medical plan for at least five years preceding retirement. Coverage is also available to the employee's legal spouse provided that certain conditions are met and to other dependents as required by law. This post employment benefit plan is funded on a pay-as-you-go basis and there are currently 11 employees eligible to receive benefits. The current annual cost is $19,800 per year. Based on life expectancies, the District recorded an expense and a liability of $313,000 during 2000.

13. DEFERRED COMPENSATION AND SAVINGS PLAN

The District has adopted and maintains the Central Arizona Water Conservation District Savings Plan (Savings Plan) in accordance with Section 401(k) of the Internal Revenue Code. The Savings Plan was amended by the District Board of Directors on May 6, 1999 to provide that all active, nonunion employees are eligible to participate as of their date of employment. The Savings Plan was further amended on December 7, 2000 to clarify that certain temporary and part-time employees do not participate.

NOTES TO FINANCIAL STATEMENTS CONTINUED

DEFERRED COMPENSATION AND SAVINGS PLAN CONTINUED

Eligible employees are allowed to contribute up to 16 percent of their biweekly compensation, and the District has agreed to contribute to an employee's account an amount equal to one-half of the amount contributed by the employee up to three percent of the employee's biweekly compensation. Contribution expense for the Savings Plan for the years ended December 31, 2000 and 1999 was approximately $629,000 and $598,000, respectively (2.7 percent of payroll expense for each plan year). Accrued benefits attributable to the District's contributions on behalf of participants vest 20 percent for each year of completed service.

The District's payroll expense for employees covered under the Savings Plan was $23,501,000 and $22,151,000 for the plan years ended December 31, 2000 and 1999, respectively.

14. OM&R COST RECONCILIATION

In accordance with CAP M&I and agricultural subcontracts, the District annually estimates its OM&R costs for the following year and uses that estimate along with projected water deliveries to establish water service OM&R charges for that following year. The subcontracts also provide that the District will determine whether its actual OM&R costs for each year differed from the estimated OM&R costs that were used to establish water charges for that year, and the District will make adjustments in the following year's charges to account for any difference identified.

The District has determined that the annual OM&R cost reconciliations should include a reconciliation of both fixed OM&R and pumping energy costs for each year to charges for each year previously established based on estimates.

The Stipulation specifies that actual OM&R costs allocable to Federal customers are to be reconciled on a basis consistent with the methodology used in each applicable year to assess charges. Reconciliations through 1999 were communicated in January 2001, and customers were given a choice between receiving a credit or a refund. Beginning with 2000, annual costs are to be calculated and refunded, surcharged or offset, as the case may be, by May 30 of the following year.

The District recorded a provision at December 31, 1999 for its estimated OM&R reconciliation obligation through 1999 in the total amount of $18 million. Subsequently, the District completed its analysis of OM&R costs through December 31, 2000 and determined that the actual OM&R obligation through 1999 was $15.6 million and for 2000 the obligation is $707,500. Consequently, the District recorded a revenue item in 2000 in the amount of $1.7 million corresponding to the reduction in its OM&R reconciliation liability.

CENTRAL ARIZONA WATER CONSERVATION DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED DECEMBER 31, 2000

The following is management's discussion and analysis of the 2000 financial performance of the Central Arizona Water Conservation District (the District). It provides an overview of the District's financial activities and financial condition for the year and should be read in conjunction with the District's financial statements and accompanying notes.

FINANCIAL HIGHLIGHTS

- Water deliveries for 2000 totaled 1.540 million acre-feet, an increase of 23% over 1999 deliveries. Deliveries for 2000 set a new record, exceeding the previous record of 1.365 million acre-feet set in 1997.
- Total net assets increased by 11% to $155 million in 2000. In 1999, total net assets decreased by 11% to $140 million, primarily due to a provision of $18 million to refund amounts charged to customers in excess of actual 1993-1999 operations, maintenance and replacement (OM&R) costs.
- Total expenses for 2000 declined by 1% to $173 million (excluding the OM&R provision for 1993-1998 in the amount of $16 million from the comparison). The reduction was due primarily to lower interest and amortization expense as a result of the District's repayment settlement, partially offset by higher power expenses related to higher water deliveries. Total revenues for 2000 increased by 8% to $189 million, due to increased water deliveries and interest income as a result of the settlement.
- Operating income for 2000 increased by 19% to approximately $21 million (excluding the OM&R provision for 1993-1998 from the comparison).
- Unrestricted cash and investments for 2000 decreased by 2% to $179 million. During 1999, unrestricted cash and investments declined by 9%.

USING THE FINANCIAL STATEMENTS

As a business-type activity, the District's annual financial reporting includes the basic financial statements and accompanying notes for enterprise funds. The District reports on a calendar year basis. All financial statements are presented on a comparative basis for 2000 and 1999. The statements of net assets summarize the District's current and long-term obligations (liabilities) and the assets available to meet those obligations. The difference between total assets and total liabilities represents the District's net assets. The statements of revenues, expenses and changes in fund net assets summarize the District's operating and non-operating expenses for the year and the revenues that were available to cover those expenses, as well as changes in net assets. The statements of cash flows summarize the District's uses of cash during the year and the sources of cash available to finance those uses. The statements of cash flows, as cash based statements, include reconciliations to the statements of revenues, expenses and changes in fund net assets, which are prepared on an accrual basis. Consolidating schedules of net assets and statements of revenues, expenses and changes in fund net assets, which provide more detailed information on the District's designated financial activities, are included after the notes to the financial statements.

MANAGEMENT'S DISCUSSION AND ANALYSIS CONTINUED

THE DISTRICT'S FINANCIAL ACTIVITIES

The District accounts for its financial activities in conformity with generally accepted accounting principles as applicable to a government "enterprise fund." This accounting treatment applies because the District's activities are primarily business-like in nature. Under enterprise fund accounting, the District is a single accounting entity for financial reporting purposes. However, within this single accounting entity the District has identified a number of financial activities that it wishes to track separately, referred to as "funds," which are actually separate accounts. These funds are as follows: General Fund, CAGRD Fund, State Demonstration Project Fund, Ak-Chin Fund and several Bond Funds. The use of the term "fund" for these separate activities does not have any particular accounting significance. The District is not required to and does not publish separate financial statements for any of the individual funds, except for the consolidating schedules referenced above.

The General Fund represents the District's primary activity, the delivery of Colorado River water to central Arizona through the Central Arizona Project (CAP) and is, by an order of magnitude, the largest fund within the District. The CAGRD Fund represents the activities of the Central Arizona Groundwater Replenishment District. The State Demonstration Project Fund represents the activities related to the construction of State Demonstration underground water recharge projects. The Ak-Chin Fund represents the activities related to a trust fund established to acquire or conserve water to supplement Colorado River supplies. The Bond Funds represent the activities related to several revenue bond series issued by the District. Please refer to the notes to the financial statements for additional information on these funds.

THE DISTRICT AS A WHOLE

The District's total assets as of December 31, 2000 were approximately $2.0 billion. Current assets, including cash, inventory and receivables, were approximately $65 million, including a $36 million credit for overpayments in prior years arising from the repayment settlement. The largest component of the District's long-term assets was the permanent service right, net of accumulated amortization, in the amount of $1.59 billion. The permanent service right is the asset representing the District's right to operate the CAP system and collect revenues from operations, for which the District has incurred a repayment obligation to the United States. Other asset categories include restricted and unrestricted reserves and investments, funds held by or advanced to the Federal government and property and equipment.

While property and equipment assets grow annually as a result of ongoing capital projects, such additions are more than offset by amortization of the permanent service right, which is approximately $31 million per year. As a result, total assets tend to decrease each year.

NET ASSETS

All Funds

	2000	1999
		(In $ Millions)
Cash and Investments	**$ 277**	$ 276
Receivables	**40**	37
Permanent service right, net	**1,586**	1,761
Property and equipment, net	**23**	16
Repayment Credit	**36**	—
Inventory and other assets	**18**	13
Total assets	**$ 1,980**	$ 2,103
Repayment obligation	**1,546**	1,665
Revenue bonds	**190**	205
OM+R reconciliation provision	**16**	18
Deferred revenue	**16**	16
Other liabilities	**57**	59
Total liabilities	**1,825**	1,963
Net Assets:		
Invested in capital assets, less than related debt	**(125)**	(91)
Restricted	**96**	92
Unrestricted	**184**	139
Total net assets	**155**	140
Total liabilities and net assets	**$ 1,980**	$ 2,103

The District's total liabilities as of December 31, 2000 were approximately $1.8 billion. Current liabilities, including payables, accrued interest, current principal obligations and the OM&R refund, were approximately $111 million. The largest component of the District's liabilities was the Federal repayment obligation in the amount of $1.55 billion. Other liability categories include revenue bonds and deferred revenue.

Total liabilities will generally decrease each year as the repayment obligation and revenue bonds are paid off. Deferred revenue consists of water delivery and capital charges collected in advance. Total fund net assets are generally expected to increase because the annual Federal repayment obligation and bond principal payments exceed amortization of the permanent service right. However, net assets will also fluctuate as a result of changes in water deliveries and reserve levels and significant accounting entries such as the OM&R provision.

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

All Funds

	2000	1999
		(In $ Millions)
Operating revenues	**$ 144.0**	$ 137.7
Operating expenses	**(123.4)**	(120.4)
Operating income before unusual expense item	**20.6**	17.3
Unusual item – OM&R reconciliation	**—**	(16.0)
Operating income after unusual expense item	**20.6**	1.3
Non-operating revenues	**44.7**	37.1
Non-operating expenses	**(49.9)**	(54.8)
Total non-operating revenues (expenses)	**(5.2)**	(17.7)
Change in net assets	**$ 15.4**	$ (16.4)

Operating revenues for 2000 grew by 5% over 1999, primarily due to increased water deliveries. Operating expenses for 1999 grew by 2% over 1999, primarily due to increased power purchases associated with increased water deliveries. Total operating income for 2000 (before an unusual expense item) grew by 19% over 1999. In 1999, an unusual expense item of $16 million was recognized for reconciliation of actual 1993-1998 OM&R costs to amounts charged to customers. Estimated OM&R reconciliation costs for 1999 of $2 million were included in 1999 operating expenses.

Non-operating revenues for 2000 increased by 18% over 1999, primarily because of increased interest earned on the repayment credit arising from the repayment settlement. Non-operating expenses for 2000 decreased by 10% from 1999 due to the decrease in the District's repayment obligation as a result of the repayment settlement. In the near term, under current rate setting practices and assuming constant reserve levels, the District's consolidated change in net assets can generally be expected to be positive. However, because rates are set in advance and water deliveries fluctuate based on weather conditions and other factors, actual results may vary. Please see the discussions under "General Fund," "State Demonstration Projects" and "Bond Funds" below for additional information.

GENERAL FUND

The General Fund represents the primary activity of the District, delivery of Colorado River water to central Arizona, and has the largest share of the District's assets, liabilities, net assets, revenues and expenses. The discussion above under "The District as a Whole" on assets, liabilities and net assets explains key considerations related to the General Fund with respect to the permanent service right, the repayment obligation and reserves. Additional discussion is provided below on General Fund revenues and expenses.

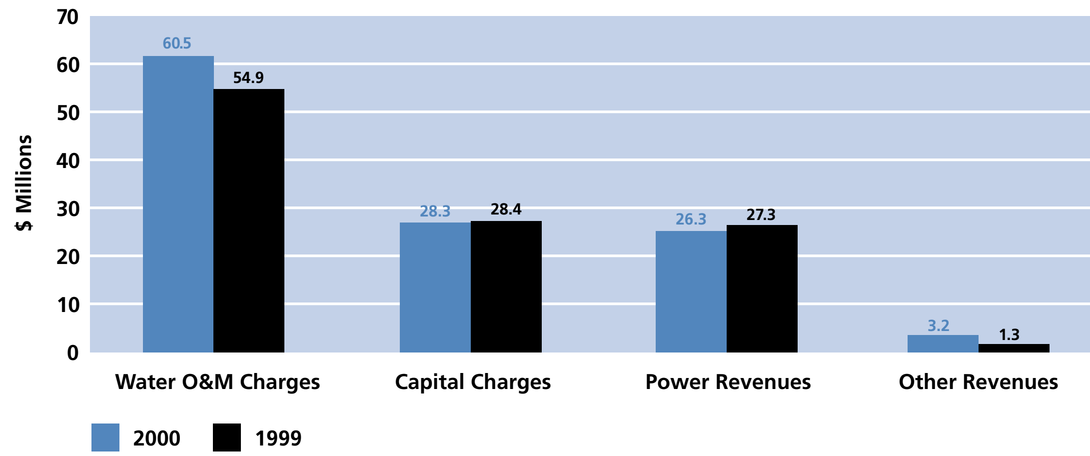
Statements of Revenues, Expenses and Changes in Net Assets
General Fund

	2000	1999
	(In $ Millions)	
Water deliveries (000 acre-feet)	**1,540**	1,253
Operating revenues	**$ 118.3**	$ 112.4
Operating expenses	**(121.0)**	(118.5)
Operating loss before unusual expense item	**(2.7)**	(6.1)
Unusual expense item –		
OM&R reconciliation	**—**	(16.0)
Operating income after unusual expense item	**(2.7)**	(22.1)
Nonoperating revenues	**40.1**	33.0
Nonoperating expenses	**(37.0)**	(41.0)
Total nonoperating revenues (expenses)	**3.1**	(8.0)
Change in net assets	**$ 0.4**	$ (30.1)

Water deliveries for 2000 set an all-time record for the District, increasing by 23% over 1999, primarily due to unseasonably dry, warm weather conditions. Total water deliveries increased in each major category, which include municipal and industrial (M&I), agricultural, federal and recharge customers. In years with cooler and/or wetter weather conditions, deliveries to M&I, agricultural and federal customers may be lower. In such years, the District's ability to deliver its full apportionment of 1.5 million acre-feet (or more in surplus years) depends on total available recharge capacity. Through 2000, recharge capacity was limited due to permitting and land acquisition delays. However, additional recharge capacity is expected to come on-line during the next five years. Please see the discussion under 'State Demonstration Projects" below for additional information.

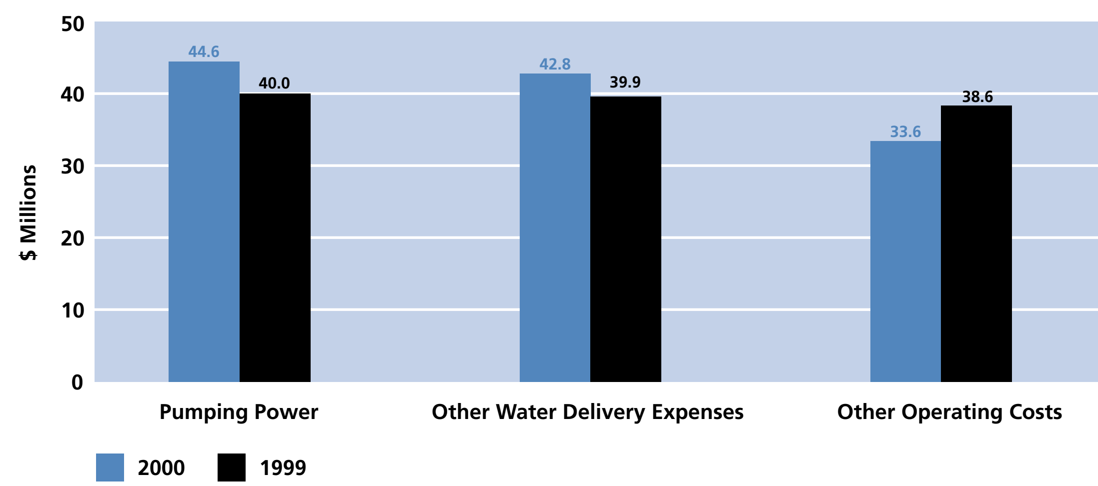
General Fund operating revenues consist of water OM&R (delivery) and capital charges, power revenues not associated with bond repayment and certain other revenues. Capital charges and power revenues remain fairly flat from year to year, while water delivery charges fluctuate based on water deliveries and the mix of customers to whom water is delivered. General Fund operating revenues for 2000 increased by 5% over 1999 primarily due to increased water deliveries.

General Fund Operating Revenues



General Fund operating expenses consist of water delivery expenses and other operating costs. Water delivery expenses consist of pumping power costs, which fluctuate with water deliveries, and other water delivery costs, which do not fluctuate materially with water deliveries, and include salaries and related costs, transmission costs, services, materials and similar expenses. Other General Fund operating costs include amortization of the permanent service right, the annual OM&R reconciliation and certain other costs.

General Fund Operating Expenses



2000 pumping power costs increased by 12% over 1999. This was due to increased water deliveries, partially offset by lower energy rates and the effect of an accounting change related to the valuation of water inventory in Lake Pleasant. Other water delivery expenses for 2000 increased by 7% over 1999, primarily as a result of non-recurring additions to services costs, a portion of which was related to the repayment settlement. Other operating costs for 2000 decreased by 13%, due to a reduction in the permanent service right amortization as a result of the repayment settlement and the $2 million OM&R reconciliation for 1999.

MANAGEMENT'S DISCUSSION AND ANALYSIS CONTINUED

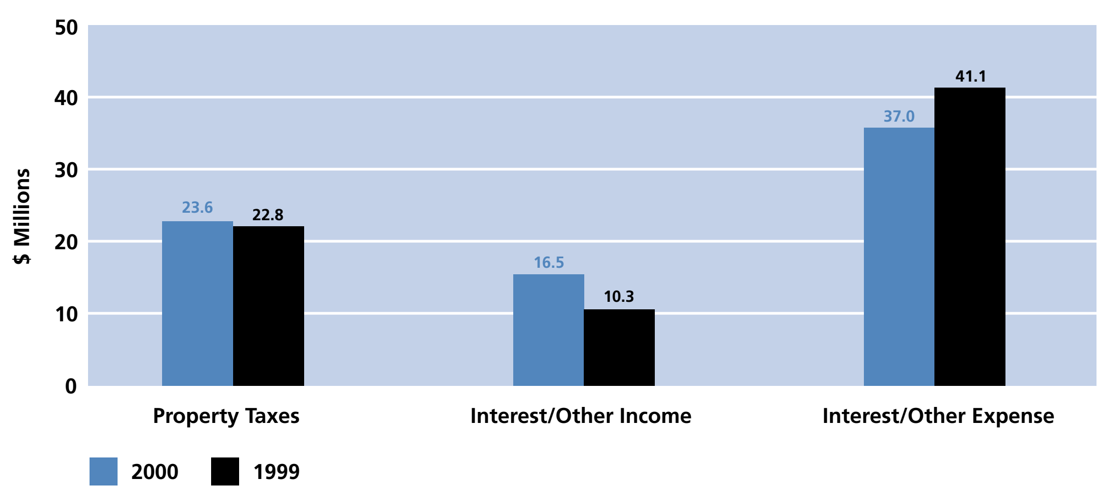
Portions of pumping power and other water delivery expenses are recovered through separate components of the water delivery rates, currently two "postage stamp" rates for purchased power and a rate for "fixed OM&R." Operating costs that cannot be recovered through rates are covered by non-operating revenues (property taxes and interest income).

Rates for each year are calculated in advance based on expected water deliveries and related costs. Actual water deliveries can fluctuate considerably due to weather conditions, and, at present, there is insufficient underground recharge capacity to absorb excess water availability. If actual deliveries fluctuate from the estimate used to set rates, water delivery revenues and pumping power costs will also fluctuate, but other water delivery expenses will not fluctuate based solely on water delivery volumes. In general, if water deliveries increase over the estimate used to set rates, operating income will increase. If water deliveries decrease, operating income will decrease. Future rates are expected to include a third "postage stamp" energy rate for interstate water banking customers and a component for future major replacements.

The District is required under certain subcontracts to reconcile actual delivery costs per acre-foot for purchased power and fixed OM&R to the rates calculated in advance that were charged to customers. Differences are to either be surcharged, in cases where the rates are lower than actual costs, or refunded, in cases where rates are higher than actual costs. Because of uncertainties regarding the definition of certain cost categories during the repayment litigation, the District was unable to reconcile water OM&R delivery costs for several years. However, because of significant progress in repayment settlement negotiations during 1999, the District was able to estimate a total liability for 1993-1999, including interest, in the amount of $18 million. Of this amount, $2 million related to 1999 was applied to 1999 operating expense and the remaining $16 million was recorded as an unusual expense item in 1999. During 2000, a final calculation for 1993-1999 determined that the amount was approximately $16 million. The amount due for 2000 was estimated at $0.7 million. The difference between these amounts and the $18 million provision was recognized as operating income in 2000.

The objective of the annual rate setting is to estimate rates that will be as close as possible to actual costs. The District has developed a long-range financial forecasting model in order to accomplish this objective. This model was used for the first time to set rates for 2000. Fluctuations in actual water deliveries may result in ongoing OM&R reconciliation adjustments.

General Fund Non-Operating Revenues & Expenses



MANAGEMENT'S DISCUSSION AND ANALYSIS CONTINUED

General Fund nonoperating revenues consist primarily of property taxes and interest income. Property taxes were collected through the 1999-2000 tax year, ending in June 2000, based on a rate of 10 cents per $100 of assessed valuation in Maricopa, Pima and Pinal counties, the legal maximum. This rate was reduced by the District's Board of Directors to 9 cents per $100 of assessed valuation for the 2000-2001 tax year. Total property tax revenues collected for 2000 increased by 4% over 1999 because of growth in the assessed valuation base. The District also collects an additional 4 cents per $100 of assessed valuation, which has consistently been transferred to the Arizona Water Banking Fund for use by the Arizona Water Banking Authority (AWBA) to buy excess CAP water for recharge. The figures shown on the District's books are net of the transfer to AWBA.

Interest income can fluctuate based on reserve levels and interest rates. Interest rates can impact both the interest earned and the fair value (yield) of the District's investments. Interest income increased in 2000 by 60% due to interest earned on the repayment credit resulting from the repayment settlement, interest earned on funds held by the Federal government (a provision of the settlement), and higher interest rates.

Interest expense for 2000 declined by 10% due to the lower repayment obligation resulting from the repayment settlement.

In the near term, under current rate setting practices and assuming constant reserve levels, the District's General Fund statement of operations can generally be expected to result in both an operating loss and a net loss. This is a timing effect. Because the District is still early in the repayment period, the current combination of permanent service right amortization and interest expense are greater than the levelized combination of these costs over time. Adjustments to reserve levels may impact future interest income.

STATE DEMONSTRATION PROJECTS

During 1990-1996, legislation authorized the District to collect a special ad valorem property tax in Maricopa and Pima counties to fund the development of State Demonstration Projects in order to increase underground storage capacity and provide for greater use of Arizona's Colorado River apportionment. Approximately $20 million was collected and deposited into the Arizona Water Storage Fund (AWSF), which is managed by the Arizona Department of Water Resources (ADWR). Through 2000, approximately $9 million has been spent on the development of several recharge projects. Three projects, Avra Valley, Pima Mine Road and Lower Santa Cruz were operational as of the end of 2000. The Agua Fria project is expected to come on line in 2001.

With interest earnings and contributions from Pima County under a cost sharing arrangement, $17 million remains available in the AWSF as of December 31, 2000. Delays in the land acquisition and permitting processes are the greatest variables facing ongoing recharge project development and can result in considerable differences in expenses from year to year.

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

State Demonstration Project Fund

(In $ Millions)	**2000**	1999
Operating revenues	**$ 0.1**	$ —
Operating expenses	**(2.1)**	(1.7)
Operating loss	**(2.1)**	(1.7)
Nonoperating revenues	**1.2**	1.0
Nonoperating expenses	**—**	—
Total nonoperating revenues	**1.2**	1.0
Decrease in net assets	**$ (0.8)**	$ (0.7)

The initial accounting treatment for this activity was to defer both the applicable property tax revenues and State Demonstration Project costs. At the end of 1996, all deferred amounts were netted and reclassified to net assets. Ongoing State Demonstration Project expenses are recorded as period operating costs and reductions to net assets. Interest income on the AWSF is recorded as nonoperating income. Reimbursements under cost sharing or similar agreements will be reflected as operating revenues.

MANAGEMENT'S DISCUSSION AND ANALYSIS CONTINUED

BOND FUNDS

In 1990, 1991, 1993 and 1994 the District issued several series of revenue bonds secured by a pledge of revenues, and related interest thereon, from an additional rate component charged by the District to the Salt River Project for certain allocated capacity and surplus energy in excess of the amounts needed from the CAP entitlement in the Navajo Power Project for delivery of CAP water. The additional rate component has been established at $6 per kilowatt of allocated capacity per month, which results in annual revenues of $25.2 million. The excess capacity and associated energy is sold under two long term power sales contracts through September 2011.

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

Bond Funds

(In $ Millions)	**2000**	1999
Operating revenues	**$ 25.2**	$ 25.2
Operating expenses	**—**	—
Operating income	**25.2**	25.2
Non-operating revenues	**3.0**	2.8
Non-operating expenses	**(12.8)**	(13.8)
Total non-operating revenues (expenses)	**(9.8)**	(11.0)
Increase in net assets	**$ 15.4**	$ 14.2

The only change from year to year is the reduction in interest expense as principal balances are paid down. It is expected that the Bond Funds will reflect flat operating income and increasing additions to net assets throughout the life of the power sales contracts.

CONTACTING THE DISTRICT'S FINANCIAL MANAGEMENT

This financial report is designed to provide our customers, taxpayers and creditors with a general overview of the District's finances and to show the District's accountability for the funds it collects. The information contained in this report supplements the information contained in the District's audited financial statements and accompanying notes and the District's annual budget package. If you have any questions about this report or need additional financial information, contact the CAWCD Finance Office, P.O. Box 43020, Phoenix, AZ 85080-3020.

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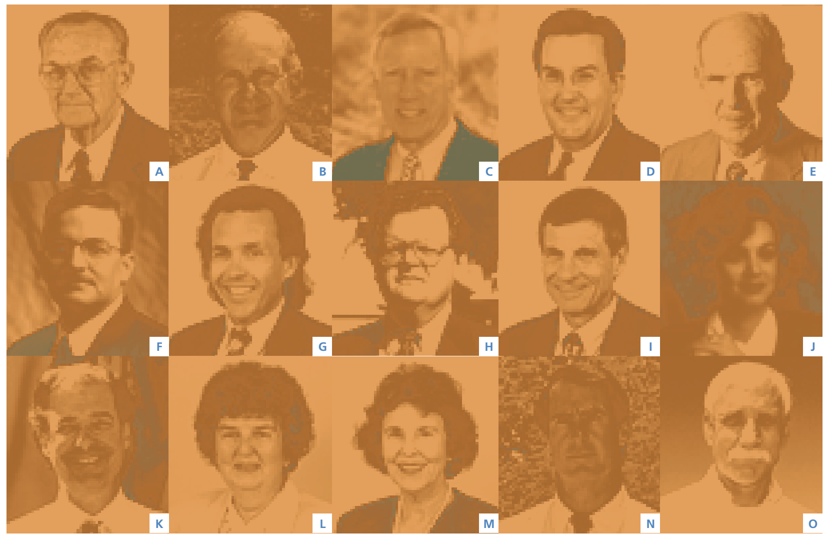
THE CAWCD BOARD

Central Arizona Water Conservation District



MARICOPA COUNTY

A	George L. Campbell	TERM ENDING 2000
B	Dalton H. Cole, Jr.	TERM ENDING 2000
C	Dan Donahoe	TERM ENDING 2004
D	Grady Gammage, Jr. Esq.	TERM ENDING 2004
E	Samuel P. Goddard, Jr. Esq.	TERM ENDING 2004
F	Mark Lewis	TERM ENDING 2004
G	William Perry	TERM ENDING 2000
H	Karl L. Polen, Jr.	TERM ENDING 2000
I	George Renner	TERM ENDING 2000
J	Susan Bitter Smith	TERM ENDING 2004

PIMA COUNTY

K	Robert M. "Bob" Beaudry	TERM ENDING 2002
L	Marybeth Carlile	TERM ENDING 2002
M	Marilyn Ronstadt	TERM ENDING 2002
N	Steve Weatherspoon, Esq.	TERM ENDING 2002

PINAL COUNTY

O	Jim Hartdegen	TERM ENDING 2002