A dynamic background image showing water being poured from a glass, creating a splash with many bubbles. The water is clear and blue, set against a white and light blue background. The splash is centered and extends across the width of the page.

# **Sonoma County Area 41 Water Districts Freestone Water Rate Study**

**May 24, 2016**

*Prepared by*

**Greg Clumpner, Director, NBS**

**Carmen Narayanan, Consultant, NBS**

# Overview of Presentation

- **Overview of Key Rate Study Tasks & Methodology**
- **Water Rate Study**
  - ✓ Key Findings
  - ✓ Overview of Financial Plan
  - ✓ Rate Study Recommendations
  - ✓ Next Steps

# Overview of Key Rate Study Tasks

## Key Components in the Water Rate Study:

### 1 FINANCIAL PLAN / REVENUE REQUIREMENTS

- Determines total revenue needed from rates.
- Determines annual % adjustments to rates needed.

### 2 COST-OF-SERVICE ANALYSIS

- Allocates revenue requirements to customer classes in a “fair and equitable” manner.
- Complies with Prop 218.

### 3 RATE DESIGN

- Determines the rate structure used to collect revenue from each customer class.
- Reflects County & District’s Policies & Rate Objectives.

## Rate Study Methodology:

- State Law (Proposition 218) requires rates be “*fair & equitable.*”
- Recent Court Cases have defined what fair & equitable mean:
  - Costs must be allocated to customer in proportion to their cost-of-service.
  - Tiered rates must demonstrate a “cost basis” for each tier.
  - The District cannot easily defend more than a single tier because of its single water supply source.
- Performing a COSA results in current rates not being increased in an “across-the-board” manner.

# Overview of Key Rate Study Tasks (cont.)

## *Water Rate Study Addresses Multiple Issues:*

### **1. Financial Issues:**

- *Collecting Adequate Revenues*
- *Funding Capital Improvement Costs*
- *Building & Maintaining Acceptable Levels of Reserves*
- *Eliminate Reliance on County Funds*

### **2. Rate Design:**

- *Tiered rates vs. Uniform (Single-Tier) Volumetric rates*

# Key Water Rate Study Findings

## Current Water Rates are Inadequate to Meet Projected Revenue Requirements Due to:

1. Under Collection of Rates & Fees.
2. Need to Fund Capital Rehabilitation/Replacement and Improvement (e.g. tank lid replacement).
3. Need to Correct Annual Deficits and Maintain Adequate Reserves.
4. Need to Eliminate Reliance on County Water Fund Subsidy.
5. Projected Cost of Inflation.

***Rates Must Be Increased (Annually)  
To Meet System Operating Costs  
& Maintain a Reliable Supply of Water.***

# Overview of Financial Plan

## Annual Budget Summary (Shows a “Structural Deficit”):

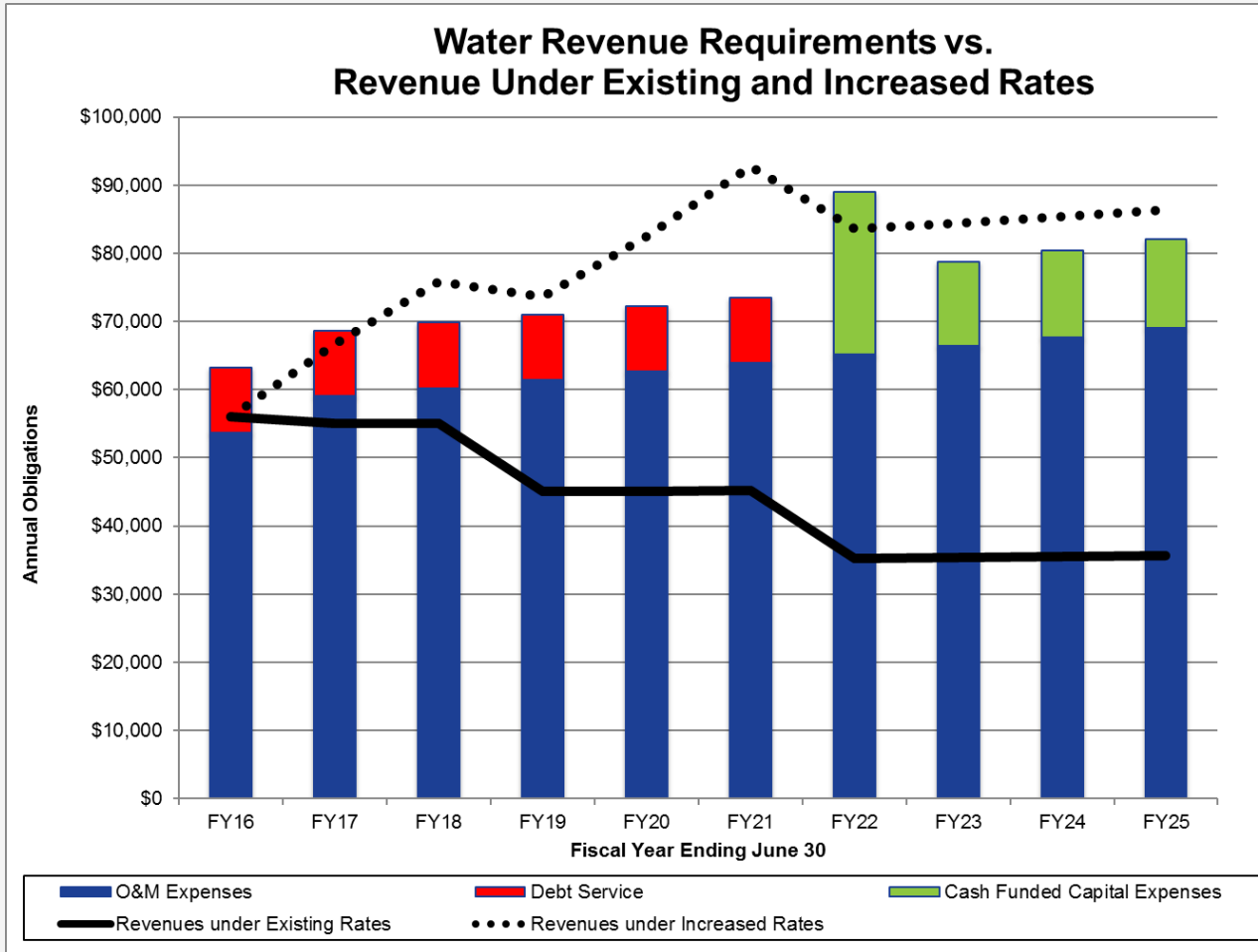
Summary of Sources and Uses of Funds and Net Revenue Requirements	Budget			Projected		
	FY 2015/16	FY 2016/17	FY 2017/18	FY 2018/19	FY 2019/20	FY 2020/21
<b>Sources of Water Funds</b>						
Rate Revenue Under Prevailing Rates	\$ 34,780	\$ 34,780	\$ 34,780	\$ 34,780	\$ 34,780	\$ 34,780
Non-Rate Revenues	21,046	20,279	20,279	10,279	10,279	10,279
Interest Earnings	138	-	-	26	60	202
<b>Total Sources of Funds</b>	<b>\$ 55,964</b>	<b>\$ 55,059</b>	<b>\$ 55,059</b>	<b>\$ 45,085</b>	<b>\$ 45,119</b>	<b>\$ 45,262</b>
<b>Uses of Water Funds</b>						
Operating Expenses	\$ 53,590	\$ 59,015	\$ 60,210	\$ 61,400	\$ 62,630	\$ 63,880
Debt Service	9,622	9,622	9,622	9,622	9,622	9,622
Rate-Funded Capital Expenses	-	-	-	-	-	-
<b>Total Use of Funds</b>	<b>\$ 63,212</b>	<b>\$ 68,637</b>	<b>\$ 69,832</b>	<b>\$ 71,022</b>	<b>\$ 72,252</b>	<b>\$ 73,502</b>
<b>Surplus (Deficiency) before Rate Increase</b>	<b>\$ (7,248)</b>	<b>\$ (13,578)</b>	<b>\$ (14,773)</b>	<b>\$ (25,937)</b>	<b>\$ (27,133)</b>	<b>\$ (28,240)</b>
Additional Revenue from Rate Increases <sup>1</sup>	-	11,593	20,729	28,500	37,359	47,459
<b>Surplus (Deficiency) after Rate Increase</b>	<b>\$ (7,248)</b>	<b>\$ (1,985)</b>	<b>\$ 5,956</b>	<b>\$ 2,563</b>	<b>\$ 10,226</b>	<b>\$ 19,219</b>
<b>Projected Annual Rate Increase</b>	<b>0.00%</b>	<b>40.00%</b>	<b>14.00%</b>	<b>14.00%</b>	<b>14.00%</b>	<b>14.00%</b>
<i>Cumulative Rate Increases</i>	<i>0.00%</i>	<i>40.00%</i>	<i>59.60%</i>	<i>81.94%</i>	<i>107.42%</i>	<i>136.45%</i>
<b>Net Revenue Requirement<sup>2</sup></b>	<b>\$ 42,028</b>	<b>\$ 48,358</b>	<b>\$ 49,553</b>	<b>\$ 60,717</b>	<b>\$ 61,913</b>	<b>\$ 63,021</b>

1. Assumes new rates are implemented July 1, 2016.

2. Total Use of Funds less non-rate revenues and interest earnings. This is the annual amount needed from water rates.

*Annual Deficiency in Rate Revenue is Not Sustainable.*

# Water Rate Study Recommendations



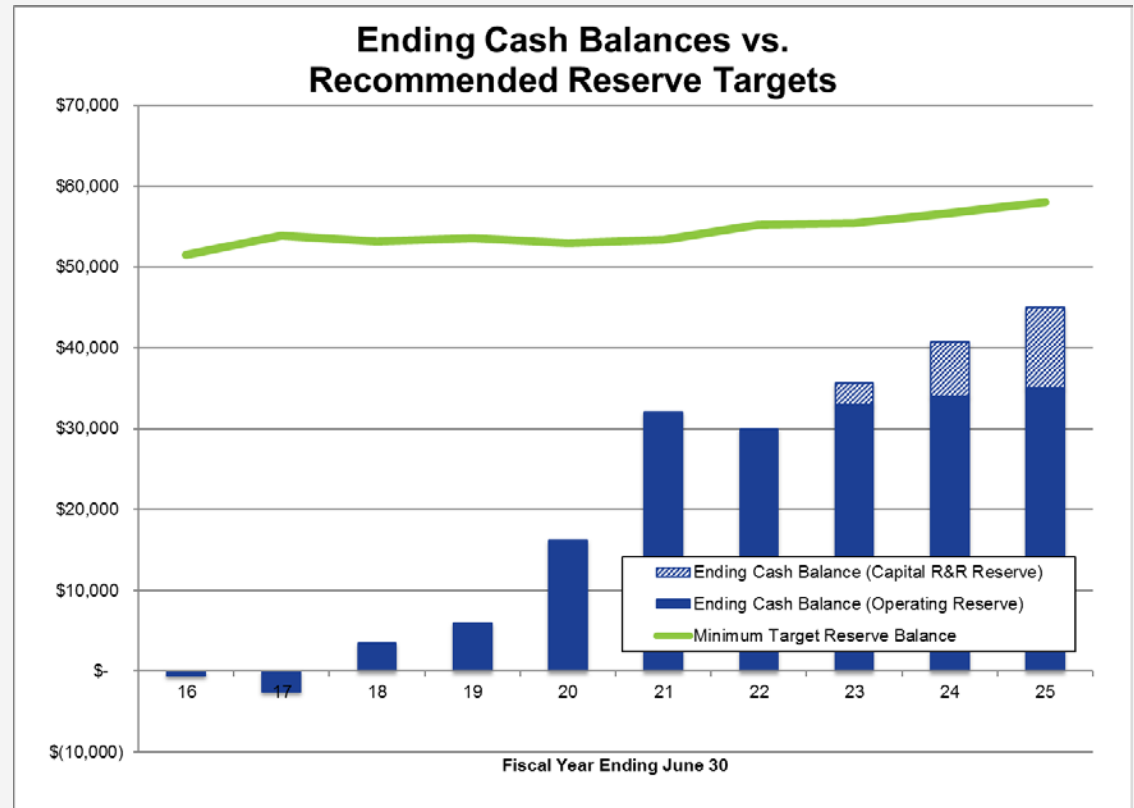
## Increase Rates Annually to:

1. Meet Revenue Requirements
2. Pay for Capital R&R
3. Build Reserves

# Water Rate Study Recommendations, cont'd.

## Recommended Reserve Fund Targets:

- 1. Operations Reserve -**  
Equal to 180-days of O&M Expenditures, or \$30,000 in FY 2016/17.
- 2. Capital Rehabilitation & Replacement Reserve –** Equal to 7% of Net Assets, or \$24,000 in FY 2016/17.





# Water Rate Study Recommendations, cont'd.

## *Recommended Improvements to Water Rate Structure:*

- 1. Use Uniform Volumetric Rates** – NBS recommends the District adopt a uniform volumetric rate structure due to:
  - Costs and quantities of water are unavailable by source of supply
  - Follows San Juan Capistrano Ruling
- 2. Fixed Charges by Customer Class** – Separating Fixed Charges into Residential vs. Commercial Charges Better Reflect actual Costs-of-Service while still maintaining a similar rate structure.
- 3. Fixed/Variable Allocation %'s** – Three Alternatives to Consider:
  - *Alternative #1* – 72% Fixed & 28% Variable
  - *Alternative #2* – 50% Fixed & 50% Variable
  - *Alternative #3* – 55% Fixed & 45% Variable

*(similar to the current rates)*

# Next Steps

## *Following this Community Meeting:*

1. County & District staff will recommend a fixed/variable rate structure and rates will be finalized.
2. Rate notices will be sent out to all property owners at least 45 days in advance of a Prop 218 protest hearing.
3. A Prop 218 protest hearing will be held prior to rates going into effect.
4. New rates will be effective September 1, 2106 (tentative).

# Questions and Discussion

## Questions



**Carmen Narayanan**  
*[cnarayanan@nbsgov.com](mailto:cnarayanan@nbsgov.com)*  
*800.676.7516*

# Tiered vs. Uniform Volumetric Rates

## ***Background Issues Related to Water Rate Structure:***

**Tiered Rates** – The San Juan Capistrano Appellate Court ruling set more stringent standards for Tiered Rates:

*“Although the opinion in Capistrano Taxpayers Association v. City of San Juan Capistrano held that tiered rates, or inclining block rates that go up progressively in relation to usage, are compatible with Proposition 218, in this instance, the court concluded that the City failed to demonstrate that the tiers correspond to **the actual cost of providing service at a given level of usage**. The court rejected reliance on Article X, Section 2 to promote water conservation as the sole basis for establishing tiers, holding **the city had to show that the various usage tiers corresponded with its actual costs of delivering water in those increments.**”*

*“...rates were not proportional to the cost of service because the City did not calculate the **incremental cost of providing water at the level of use represented by each tier**. Specifically, the court criticized the City for not **correlating its rates within each tier to the prices of water used within each tier.**”*

Source: “Legal Alerts – California Court of Appeal Holds City's Tiered Water Rate Structure Violates Proposition 218” by Kelly Salt, Best Best & Krieger, April 21, 2015.