



Date: March 29, 2017
TO: LOCSD Board of Directors
FROM: Rate Study Working Group
Rob Miller, Richard Margetson, Ron Munds
SUBJECT: **Agenda Item 7A – Special Board Meeting Date: April 11, 2017**
Consideration of Reserve Policies, Revenue Allocations, and Rates for the Water Enterprise Fund

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DESCRIPTION

After collaborating with the Financial Advisory and Utilities Advisory Committees, staff is recommending the implementation of revised water rates and reserve policies sufficient to meet the financial obligations of the District, accrue prudent reserves, and provide for the critical capital requirements of the water system.

SUMMARY OF STAFF RECOMMENDATION

Staff recommends that the Board adopt the following motion:

Motion: I move that the Board:

- 1. Adopt Resolution 2017-11 amending District Reserve Policies relating to the Water Enterprise Fund;***
- 2. Direct staff to implement revised administrative and property tax allocations for future Water Fund budgets as follows:***
 - a. Allocate 80% of the District's administrative cost to the Water Fund***
 - b. Reallocate property tax revenue from the Water Fund to funds with a District-wide benefit in the following percentages: 25% reduction in FY 17/18, additional 12.5% reduction in FY 18/19, and additional 12.5% reduction in FY 19/20, for a total of 50% over three years.***
 - c. Establish the policy that the long-term goal of the District is to reallocate 100% of property tax revenue away from the Water Fund to funds that provide a District-wide benefit.***
- 3. Review and approve the water rate analysis and direct staff to issue the appropriate public notice in accordance with Proposition 218, and set the date of a public hearing to consider a water rate increase***

DISCUSSION

In December, 2014, the Board adopted a water rate increase to provide adequate revenue to operate the water system, fund a portion of District administration, and provide for critical capital projects necessary to sustain the District's water supply and address deficiencies within its aging water infrastructure. The rate increase was scheduled to take place over a period of four years, and the following rates were adopted as shown in Table 1, as recommend by the 2014 Rate Study prepared by Bartle Wells Associates (December, 2014). Two of the scheduled rate increases have already occurred.

Table 1: Summary of Previously Adopted Water Rates by Fiscal Year					
		Adopted Water Rates by Fiscal Year			
		FY 15/16	FY 16/17 (current)	FY 17/18	FY 18/19
Fixed Bi-Monthly Service Charge		\$52.36	\$59.32	\$64.64	\$70.42
Water Consumption Charges					
Rate per hundred cubic feet (ccf) per bi-monthly billing period					
Tier 1	0 - 5 ccf	\$2.00	\$2.35	\$2.50	\$2.60
Tier 2	6 – 10 ccf	3.75	4.40	4.80	5.20
Tier 3	11 – 20 ccf	6.00	6.75	7.25	7.80
Tier 4	>20 ccf	8.20	9.20	9.80	10.40
Expected revenue from service charge and water sales from 2014 Rate Study		\$2.1 M	\$2.3 M	\$2.4 M	\$2.5 M

The planned revenues contemplated in the 2014 Rate Study (last row in Table 1) have not been realized, primarily due to a decrease in the number of water units sold. The volume of water sold has decreased by 30% compared to calendar year 2013. As a result, revenues have fallen short of the planned target by approximately \$300,000, which has hindered the District’s ability to move forward with critical capital projects. In addition, staff is recommending adjustments in the allocation of administrative costs and property tax revenue that will result in a net additional annual impact to the Water Fund of approximately \$220,000. These adjustments are described in additional detail below.

Recommended Adjustments in Administrative Allocation

After consulting with the Financial Advisory (FAC) and Utilities Advisory (UAC) Committees, staff recommends an increase in the administrative allocation applicable to the Water Fund. The current percentage in the adopted FY 2016/17 budget is 62%, resulting in a budgeted expense of \$365,000. Staff recommends that the allocation increase to 80% in FY 2017/18, with a projected amount of approximately \$469,000. This change will reduce the administrative allocation of other funds, with a projected allocation to the Fire Fund of 10%.

Recommended Reallocation of Property Tax Revenue

The Water Fund currently receives approximately \$224,000 per year of property tax revenue from the County. This amount changes annually in proportion to the overall assessed value of the property, which has historically resulted in annual increases in the amount allocated to the Water Fund. This revenue is not based on a special assessment or special tax, and therefore it is not separately listed on the County’s property tax bill sent to each property owner within the District’s water service area. Given that the Water Fund only benefits approximately 50% of the population within the District, the equity of the current structure has been the subject of extensive discussion at the Board and Committee level. It should be noted that the Board has no legal obligation to change the allocation. After reviewing the issue in detail, including the impacts on water rates, the FAC and UAC unanimously recommended that the Board adopt the following two policy positions with respect to property tax revenue:

1. Reallocate property tax revenue from the Water Enterprise Fund to funds with a District-wide benefit in the following percentages: 25% reduction in FY 17/18, additional 12.5% reduction in FY 18/19, and additional 12.5% reduction in FY 19/20, for a total of 50% over three years.
2. Establish the policy that the long-term goal of the District is to reallocate 100% of property tax revenue away from the Water Enterprise Fund to funds that provide a District-wide benefit.

The water rate analysis completed by staff projects revenues and expenses for three years, and includes the assumption that the proposed changes in the administrative percentage and property tax allocation are adopted.

Proposed Water Rates

The 2014 Rate Study included a Capital Improvement Program (CIP) that was adopted by the Board. The CIP included critical water supply projects consistent with the Basin Plan, as well as other high priority projects to address aging or insufficient distribution infrastructure. The minimum annual net revenue required to support these projects is approximately \$500,000 per year, which can then be allocated to various methods of funding projects such as capital reserves, annual pay-as-you-go projects, or additional debt financing. Net revenues are also important to satisfy coverage requirements established by funding entities such as the I-Bank. After reviewing various capital funding scenarios and the associated impacts on rates, the FAC and UAC recommended a three-year rate structure sufficient to fund the District's CIP program in the following amounts:

- Fiscal Year 2017/18: \$500,000
- Fiscal Year 2018/19: \$700,000
- Fiscal Year 2019/20: \$900,000

Staff has assembled a three-year rate structure to accomplish the policies and objectives listed above. The rate structure is intended to provide a higher level of revenue stability compared to the 2014 Rate Study, which is focused more heavily on water conservation. This is accomplished by raising the rates in the lower tiers by a higher percentage than the upper tiers, as well as including increases in the fixed bi-monthly service charge. The proposed rates are summarized in Table 2, and annual projections of revenues and expenses are provided in Exhibit A. Inflation is projected to increase expenses by 3% in future years, and future recycled water revenues are discounted by 10%.

Table 2: Summary of Recommended Water Rates by Fiscal Year					
		Current Rates	Proposed Rates		
			FY 17/18	FY 18/19	FY 19/20
Fixed Bi-Monthly Service Charge		\$59.32	\$65.00	\$70.00	\$76.00
Water Consumption Charges					
Rate per hundred cubic feet (ccf) per bi-monthly billing period					
Tier 1	0 - 5 ccf	\$2.35	\$5.00	\$6.00	\$7.00
Tier 2	6 – 10 ccf	4.40	6.75	7.75	8.75
Tier 3	11 – 20 ccf	6.75	8.50	9.50	10.50
Tier 4	>20 ccf	9.20	10.25	11.25	12.25
Expected net revenues available for capital projects (capital reserve, pay-as-you-go, additional debt service)		N/A	\$500,000	\$700,000	\$900,000

During the discussion of this item, staff will be prepared to display an automated rate model if the Board wishes to see the impact of various rate changes not listed in Table 2. The financial impact to the District's customers will depend on the quantity of water purchased. A common bi-monthly water consumption volume is 12 hundred cubic feet (ccf), which equates to approximately 150 gallons per day. Using this metric, staff has prepared a bi-monthly bill comparison as shown in Table 3. The Golden State Water Company totals are based on a ¾" meter using the rates that will be implemented in April, 2017, according to the company's website. It should be noted that the other communities listed are likely to raise rates in future years, so care should be taken when comparing future LOCSO rates with current rates from other purveyors.

Table 3: Bi-monthly Water Bill Comparison Assuming 12 ccf of Consumption				
Purveyor	Current Amount	Proposed Bi-Monthly Bill Amount (12 ccf)		
		FY 17/18	FY 18/19	FY 19/20
LOCSO based on rates in Table 2	\$107	\$141	\$158	\$176
Golden State Water Company (April 2017 rates)	\$164			
City of Morro Bay (July, 2017 rates)	\$144			
Cambria CSD (with Supplemental Water Facility operating)	\$167 (\$137 without SWF)			
City of San Luis Obispo	\$124			

The District currently charges all users the same bi-monthly fixed charge, regardless of meter size. Morro Bay, Cambria, and the City of San Luis Obispo use the same approach. Golden State changes the fixed charge based on meter size. While staff is not recommending any changes to the current approach at this time, the District could consider varying its fixed charge in the future. Currently, the District has very few residential meters that are larger than ¾".

Staff recommends that the Board enact the motions listed on page 1 of this staff note to enact the policy decisions and rates described above. The text of a proposed resolution to amend District reserve policies consistent with UAC and FAC recommendations is included as Exhibit B. Staff plans to bring back additional recommendations on the Capital Reserve Policy at the June meeting if the rate study is approved by the Board. If the Board chooses to move forward as recommended, staff will begin the process of notifying its customers as required by Proposition 218. Customers will be provided a minimum of 45 days of notice, and a public hearing date will be set for early June to adopt the rates. If adopted, the rates will supersede the previously adopted increases, and will become effective on July 1, 2017.

FINANCIAL IMPACT

If the Board chooses to implement staff's recommendations, revenues within the Water Fund are expected to increase over the next three years, with amounts sufficient to fund capital projects in the amount of \$500,000 for FY 17/18, \$700,000 for FY 18/19, and \$900,000 for FY 19/20. The above rate analysis was completed at no cost to the District through the efforts of the rate working group, UAC, and FAC.