



Agenda Item No. 7
Meeting Date: September 19, 2018
Resolution: No

AGENDA DOCKET FORM

SUBJECT: 2019 RATE REVIEW ASSUMPTIONS


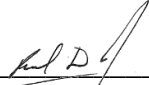

SUMMARY: The District’s Rate Setting Policy (Attachment 1) provides for an annual review of water rates, fees, and charges to ensure that sufficient funding is available to meet the District’s operating, capital, and debt service requirements. The current rate review is based on projections in the 2019-2028 Capital Improvement Program and Ten-Year Financial Plan (CIP), as adopted by the Board of Directors (Board) in February 2018, and the FY19-FY20 Budget, as adopted in June 2018. The assumptions that form the basis for the annual rate review are annually presented to the Finance Committee and to the Board as part of a three-step review of rates and charges. The review starts with concurrence by the Finance Committee and subsequently the Board on the assumptions to be used in the rate model. This is followed by a projection of revenue requirements for the following year. Based on Board approval of the revenue requirements, rates for untreated and treated water are calculated and presented to the Board for consideration of adoption following a public hearing. The proposed 2019 rate review assumptions were reviewed with the Finance Committee on August 29, 2018 and are provided as Attachment 2. The Draft Finance Committee report is included as Attachment 3. This step in the process is occurring earlier than in prior years so that the assumptions can be reflected in the Draft Administrative Record for the alternative rate structure, which is scheduled for Board review in October.

The 2019 rate review assumptions are generally consistent with the Board-adopted FY19-FY20 Budget and the CIP, with one adjustment proposed to reflect higher reserve balances than projected. The District’s planned use of reserves was less than expected, which leaves \$15.3 million more in the reserve balance to start the year than projected in the CIP.

(Continued on page 2)

FISCAL IMPACT: Not Applicable.

RECOMMENDED ACTION: Review and concur with the 2019 rate review assumptions and with incorporation of assumptions into the District’s revenue requirement analysis.

 <hr/> Desiree Castello Director of Finance	 <hr/> Ronald D. Jacobsma Assistant General Manager	 <hr/> Jerry Brown General Manager
--	--	---

DC:dmg

Attachments: 1) Rate Setting Policy; 2) 2019 Rate Analysis Assumptions; 3) Draft August 29, 2018 Finance Committee Report (Excerpt); 4) Proposed 2019 Water Rate Review Schedule

AGENDA DOCKET FORM

SUMMARY (Continued from Page 1):

The \$15.3 million higher reserves include \$6.9 million in capital rebudgets that are rate funded from FY18 to FY19 to align with project schedules. Capital rebudgets represent a shift in cash flows and do not create new funding. The remainder reflects \$8.4 million in FY18 positive financial results. The Board typically considers the allocation of financial plan benefits in conjunction with its review of annual financial results. In order to provide flexibility to meet the upcoming peak debt service payment, the Board will consider reallocation of the financial plan benefits in the context of its annual review of the District's Reserve Policy. The policy is scheduled for review by the Finance Committee on November 1, 2018 and the Board on November 14, 2018. Although the District's reserve position remains strong, the transition to declining debt payments creates new challenges and opportunities that need careful management. For example, the rate of spend down of the rate stabilization fund will need ongoing evaluation.

Next Steps

Pending Board concurrence, the assumptions reflected in this report will be incorporated into the District's revenue requirements and rate structure analysis. The rate review evaluates revenue increases from water sales and facility reserve charges needed to support the operating expenditures, capital investments, and debt service payments identified in the FY19-FY20 Budget and the CIP. The projected revenue requirements will be provided to the Board for review on December 5, 2018.

Proposition 218 Notices

In accordance with Proposition 218, notices will be mailed to all District untreated and treated water customers in mid-November, at least 45 days in advance of the public hearing. The notices will provide information regarding all proposed rate adjustments and the reasons for the adjustments. The proposed rates on the notices would be based on a revenue increase of up to 6.0% for treated water and untreated water, consistent with the FY19-FY20 Budget and the CIP. Separately explained, but contained in the same notices, will be the changes resulting from the rate structure analysis (assuming the Board supports the draft administrative record, scheduled for review on October 17, 2018). The notices will provide instructions to customers on where to receive additional information and tools (including an online rate estimator for treated water customers). The Proposition 218 notices will also inform customers of the public hearing to be held on January 2, 2019, after which the Board will consider adoption of the proposed rate adjustments.

RATE SETTING POLICY

- Revenues, expenditures and reserve funds will be reviewed annually to ensure that sufficient funding is available to meet the District's operating, capital and debt service costs.
- Rate adjustments will be planned in advance with a ten-year forecast period to provide for minimal orderly adjustments in order to avoid large sporadic rate increases.
- The District's rate setting efforts will attempt to ensure that rate adjustments are limited to a level which is at or below the current rate of inflation with the goal of consistent smaller increases versus infrequent larger increases (e.g. double digit).
- Rates and charges will be developed in an equitable manner that reflects the cost of service and provides for the long-term efficient operation of the District.
- The water rate structure will be developed in a manner which maintains or enhances the District's credit rating in the most cost-effective manner.
- Reserves will be maintained at a level sufficient to fund at least six months projected operating costs.
- Rates will be set at a level sufficient to maintain a debt service coverage ratio of at least 1.25 to 1.
- The annual rate review will take place after the Board of Directors adopts its *major* expenditure programs (Capital Improvement Program, Budget).

2019 Rate Analysis Assumptions

Consumption

The 2019 rate review will use the consumption estimates based on the FY19-FY20 Budget and the long-term CIP projections. The estimates reflect gradual increases in consumption, with increases of 2% in both 2019 and 2020. Actual consumption in FY18 was 84.4 thousand acre-feet, a 6% increase over the prior year. The ten-year projected consumption level in the CIP reflects both recent consumption trends and the projected impact of the state's long-term water use efficiency regulations.

Table 1 – Assumed Annual Consumption (in thousand acre-feet)

2019	FY19	FY20	FY21	FY22	FY23	FY24	FY25*	FY26	FY27	FY28
Rate Review	85.8	87.4	90.3	91.9	93.2	94.3	95.1	96.0	96.9	97.8

*FY25 consumption reflects the initiation of the State's Long-Term Water Use Efficiency Regulations and the District's estimated target.

Facility Reserve Charges

The Facility Reserve Charge (FRC) is a one-time charge that ensures new customers pay their fair share of the costs associated with the facilities required to provide water service. There are two aspects of the FRCs that need to be evaluated as part of the annual rate review. The first relates to annual connections. Table 2 shows actual connections made during the prior year and the projected connections over the next ten years, based on the FY19-FY20 Budget and the CIP. The average annual projections will be re-evaluated during the next CIP update in February 2019. The second part of the evaluation involves inflation adjustments for the applicable components of the FRCs, which will be based on the Engineering News Record (ENR) construction cost index for the period of November 2017 through October 2018.

Table 2 – Facility Reserve Connections

	Actual	Projections							
	FY18	FY19	FY20	FY21	FY22	FY23	FY24	FY25	FY27- FY28
2019 Rate Review									
Untreated Water	479	600	650	890	940	990	1,030	1,060	1,080
Treated Water	173	120	130	150	170	190	210	220	220

Interest Income

Interest income is earned on District reserves and maintained in appropriate funds as designated by Board policy. The interest earning rates on investments are projected to increase modestly from FY18 and are consistent with the FY19-FY20 Budget and CIP, and will be re-evaluated during the next CIP update. Table 3 shows the actual interest earnings rate from the prior year and the projected rates for the next ten years.

Table 3 – Interest Earnings

Actual	Projections				
FY18	FY19	FY20	FY21	FY22	FY23-FY28
1.50%	1.50%	1.80%	3.00%	3.50%	4.00%

Inflation

The FY19-FY20 Budget and CIP incorporated inflationary increases. The Consumer Price Indices (CPI) for urban wage earners and clerical workers increased 4.0% for the twelve months ending June 30, 2018. Inflation is assumed at 3.5% for operating expenses and 4.0% for capital expenses in each of the remaining years of the ten-year planning period. Central Valley Project water rates are assumed to increase 7% per year based on historical rate adjustments.

Operating Expenses

Operating expenses, as shown in Table 4, are based on the adopted FY19-FY20 Budget and the CIP. These expenses include operations, maintenance, and administrative costs. Operating cost impacts resulting from capital projects are incorporated into the operating cost projections in the year the related facility is projected to come on line.

Table 4 – Assumed Operating & Maintenance Expense (in millions of dollars)

	FY19	FY20	FY21	FY22	FY23	FY24	FY25	FY26	FY27	FY28
2019 Rate Review	\$83.8	\$86.9	\$98.5	\$104.1	\$109.9	\$115.7	\$121.8	\$129.1	\$134.5	\$141.4

Debt Service

Debt service expenditures are based on projections in the FY19-FY20 Budget and the CIP.

Capital Projects

Capital expenditures reflect the FY19-FY20 budget and will incorporate the FY18 capital project rebudgets. Projections for FY21 through FY28 are based on the CIP.

Reserves

Reserves are utilized, as necessary, throughout the ten-year rate projection period to enable modest revenue increases for both untreated and treated water customers. The CIP anticipates that reserve balances used to smooth rates will be drawn down to the Board-established minimum level of six months of projected operating expenses by the end of the ten-year rate review period. Limiting the reserve spend down at this time is important to improve near-term cash flows to meet the \$37.5 million in debt service payments due on October 1, 2018. It also avoids an unscheduled drawdown of the Rate Stabilization Fund. Cash flow concerns are typically eliminated by the end of October with the receipt of water sales revenue from peak summer usage.

Debt Service Coverage

The District's bond covenants, as well as Board policy, require the District to maintain a revenue-to-debt service coverage ratio of 1.25 on parity debt, including water revenue bonds and water revenue notes, and ratio of 1.15 on extendable municipal commercial paper. The 2019 rates will be set at a level sufficient to maintain the required debt service coverage ratios for all years.

Other Fees and Charges

In addition to water rates, all of the District's fees and charges will be reviewed for alignment with the cost of providing the services. The proposed changes will be presented to the Board for consideration of adoption on January 2, 2019.

**REPORT OF THE
FINANCE COMMITTEE MEETING
Draft (Excerpt)
August 29, 2018**

Attendees:

Directors: Connstance Holdaway, Vice President and Chair

Staff: Jerry Brown, Ron Jacobsma, Steve Welch, Desiree Castello, Jeff Quimby, Fran Garland, Lizz Cook, Celia Cheung, Michele Bautista, and Donna Grimes

Public: None

2019 Rate Review Assumptions

Staff presented the recommended assumptions to be reflected in the 2019 rate analysis. The assumptions are largely based on the FY19-FY20 Budget and the 2019-2028 Capital Improvement Program and Ten-Year Financial Plan (CIP). One adjustment is proposed to reflect higher than projected reserve balances due to lower reserve use during FY18. The proposed assumptions will be presented to the Board on September 19, 2018 and, with the Board's concurrence, will be used to establish the revenue requirements for 2019. In accordance with the rate setting policy, rates will be set at a level sufficient to maintain required debt coverage ratios. In response to Vice President Holdaway, Ms. Castello stated that current projections anticipate the need for a 6.0% revenue requirement for 2019, consistent with the CIP. The schedule for the 2019 rate review process was reviewed with the Committee. The rate assumptions will be brought to the Board for review in September. This is earlier than in prior years so that the assumptions can be reflected in the Draft Administrative Record for the alternative rate structure, scheduled for Board review in October. Updated revenue requirements will then be presented for Board concurrence on December 5, 2018. Until the 2019 rates are considered by the Board in January 2019, the Board will retain the ability to modify the revenue requirements up to the percentage reflected on the Proposition 218 notices. The schedule anticipates mailing of these notices on or before November 16, 2018.

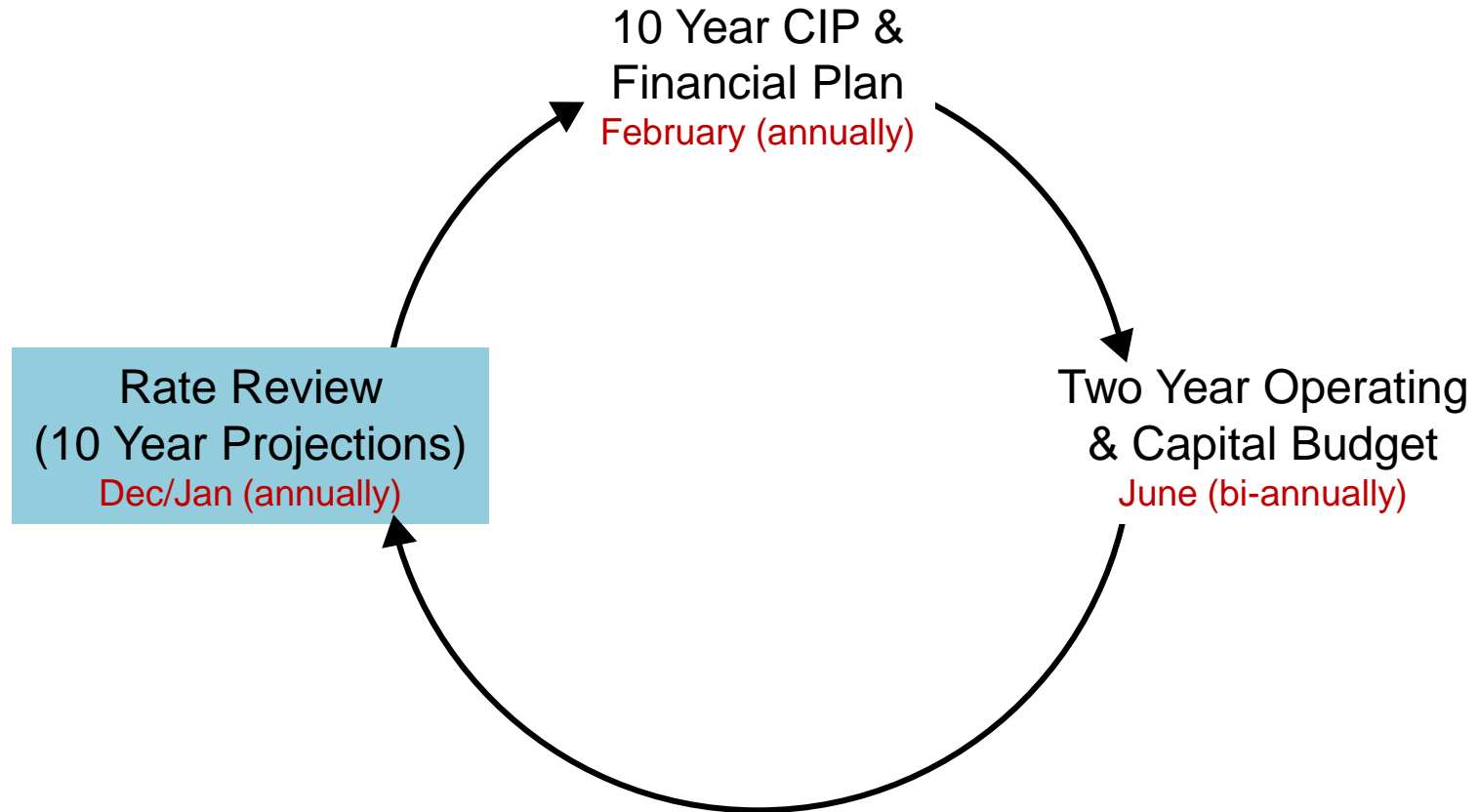
DC:dmg

**PROPOSED
CONTRA COSTA WATER DISTRICT
2019 WATER RATE
REVIEW SCHEDULE**

08/29/2018	<u>Finance Committee</u> Review Rate Assumptions
09/19/2018	<u>Board of Directors</u> Review Rate Assumptions
10/17/2018*	<u>Board of Directors</u> Review Draft Administrative Record
11/16/2018*	<u>Proposition 218 Notices Mailed</u>
12/05/2018	<u>Board of Directors</u> Review Revenue Requirements
01/02/2019	<u>Board of Directors</u> a) Public Hearing to Present Proposed Water Rates, Fees, and Charges Adjustments b) Consider Adoption of Final Administrative Record c) Consider Adoption of Resolution Approving Proposed Water Rates, Fees, and Charges Adjustments
02/01/2019	Effective Date for Water Rates, Fees, and Charges Adjustments
04/01/2019	Effective Date for Facility Reserve Charge Adjustments

** Date has been revised since Finance Committee review to reflect current schedule.*

Financial Planning Cycle



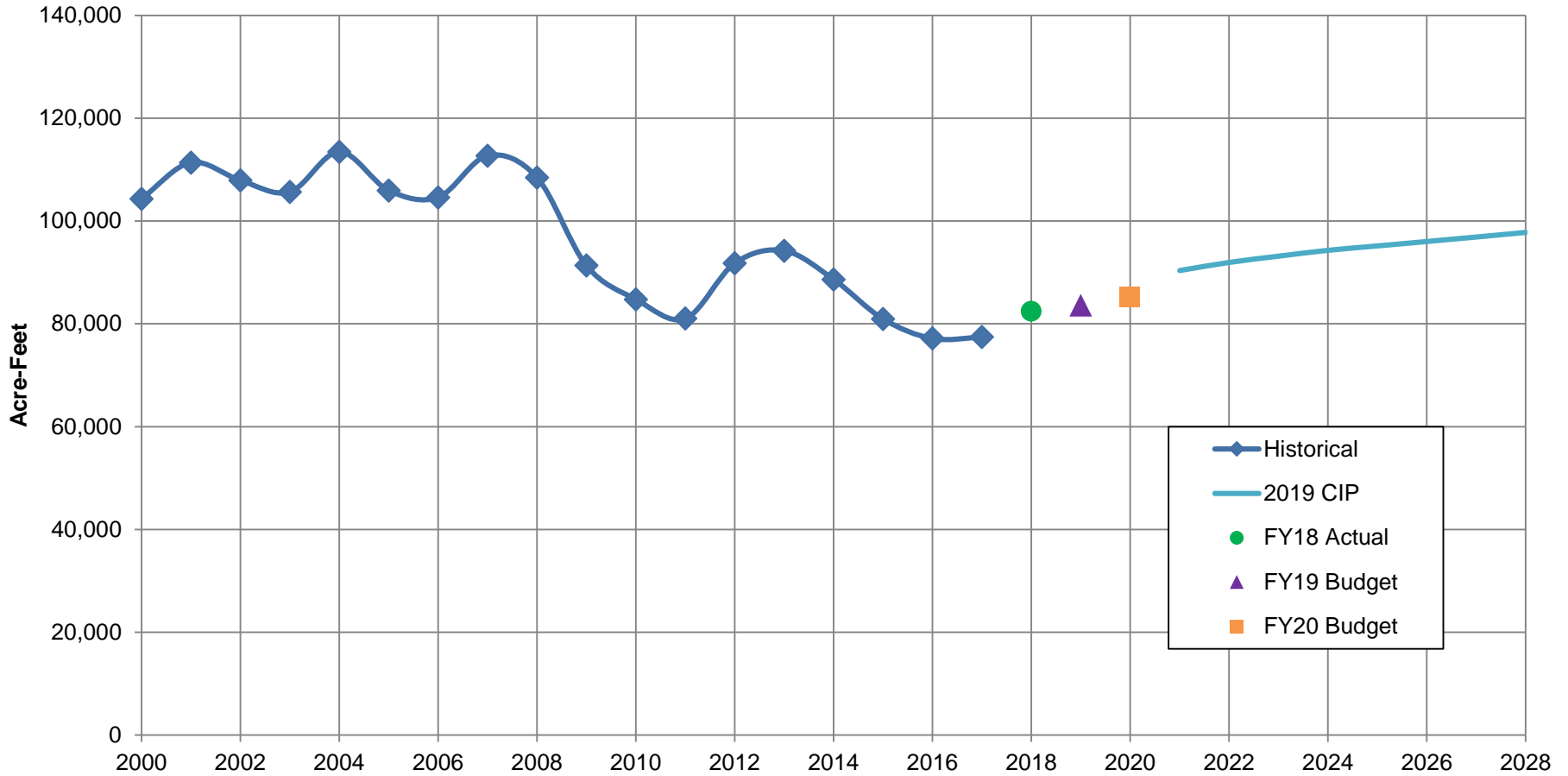
Key Messages

- Assumptions for 2019 rate review are based on
 - FY19-FY20 Budget
 - 2019-2028 Capital Improvement Program & Financial Plan
- Allocation of higher beginning reserves to be considered with November's Reserve Policy update
- Assumptions reviewed at August 29 Finance Committee meeting, earlier than in prior years to be reflected in the Rate Structure's Administrative Record

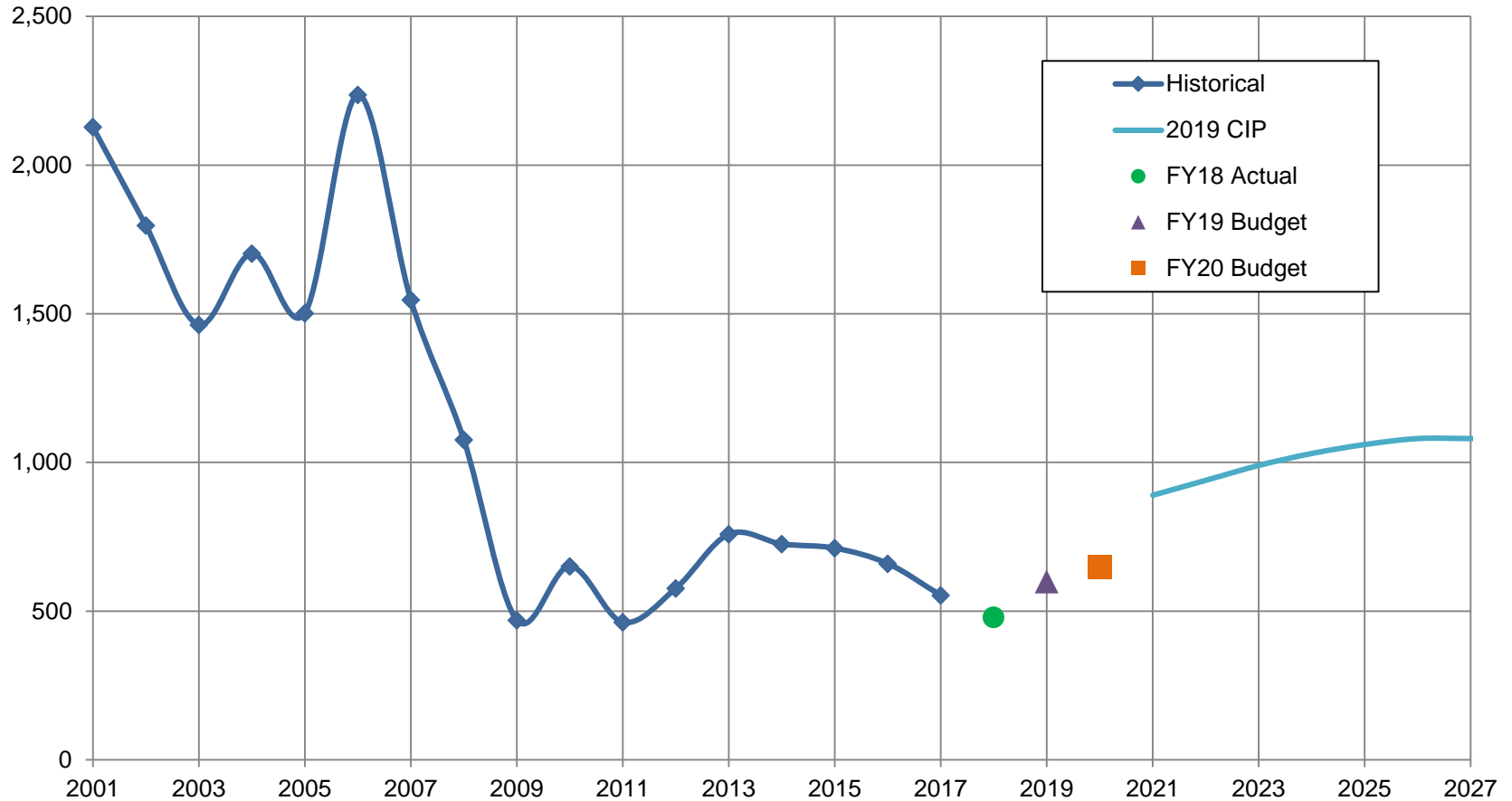
Recommended Key Assumptions

- Based on FY19-FY20 Budget and CIP thereafter:
 - Water Sales Projections
 - Facility Reserve Charge Projections
 - Interest Income

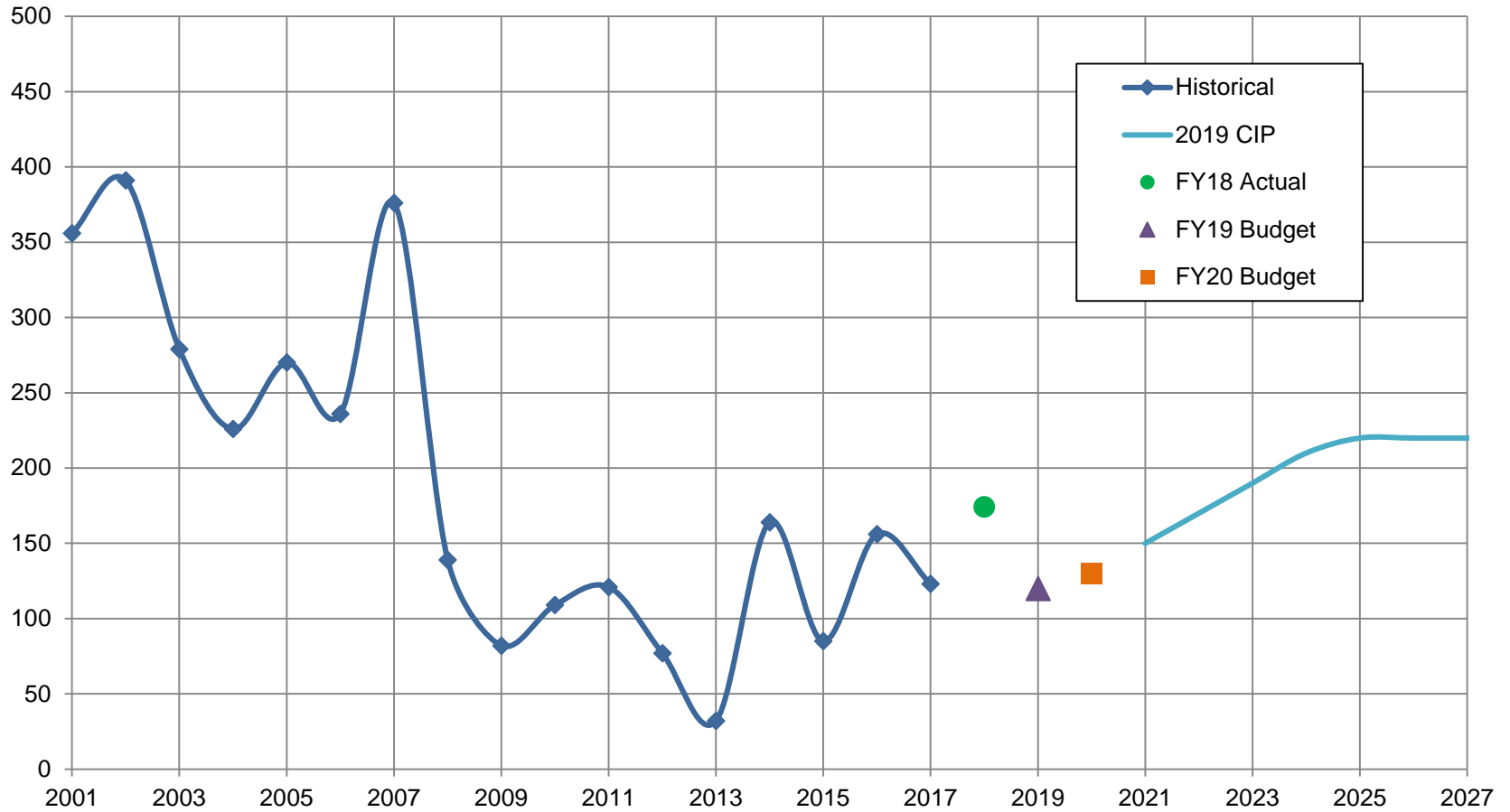
Water Sales Projections



Untreated Water New Connections



Treated Water New Connections



Other Key Assumptions

- Based on FY19-FY20 Budget; CIP thereafter
 - Expenditure Projections
 - Capital projects include \$8.4M in FY18 rebudgets
 - Inflation of 3.5% for operating, 4.0% for capital
 - Reserve use to smooth rate increases
 - Balances, allocations to be reviewed in November
- Maintain minimum debt service coverage

Schedule

- **Board of Directors - Assumptions** **Sep. 19, 2018**
- Board of Directors – Draft Admin Record for Rates Oct. 17, 2018
- Proposition 218 Notices Mailed Nov. 12, 2018
- Board of Directors - Revenue Requirements Dec. 5, 2018
- Board of Directors Jan. 2, 2019
 - Public Hearing on Proposed Changes
 - Consider Adoption of Final Administrative Record
 - Consider Adoption of Rates, Fees, Charges
- Water Rate Changes Effective Feb. 1, 2019
- FRC Adjustments Effective Apr. 1, 2019