

**Metropolitan Domestic Water Improvement District
Board of Directors Meeting**

March 30, 2015

**Enhancement of Revenue Stability through Adjustment of Rates & Fees and
Scheduling of a Public Hearing**

Synopsis

The Board of Directors is requested to discuss scheduling a public hearing to consider adjusting the rate structure to enhance revenue stability by better balancing revenue generated for fixed and variable expenditures. In addition, the public hearing would also include consideration to change fees to ensure those fees capture the cost of service.

Background

Last year, the Board of Directors, Finance Oversight Committee and staff discussed how the District could better meet the customer needs through water resources stability, revenue stability, and financial cycle stability. Water resources stability was ensured first through targeting modest increases to the Water Resources Utilization Fee, which included the Board approving a 20 cent increase effective November 1, 2014. This year, revenue stability can be achieved by restructuring the rate schedule to have fixed revenue cover more of the fixed costs in a way that has minimal impact to the average customer. Financial cycle stability would also be accomplished this year by having the rate adjustment aligned with planned expenses while developing the fiscal year budget.

At its March 23, 2015 meeting, the Finance Oversight Committee discussed with staff how both revenue stability and financial cycle stability can be realized this year. Staff would like to present that plan to the Board of Directors for discussion and direction at the March 30, 2015 study session.

In prior years, the District would adopt its budget to be followed a few months later with a revenue review that generally led to a proposed rate adjustment. Best financial practices require establishing available revenue prior to planning expenditures. Therefore, this year, District staff is seeking to have revenue decisions, including rate adjustments, made before action is taken on the financial plan. This would ensure the financial plan and rates are both in place for the beginning of the fiscal year, which would provide financial cycle stability. Per the positive feedback last year from the Board and the Committee, staff has developed a budget based upon current revenue and another one based upon proposed revenue adjustments becoming effective July 1, 2015.

Revenue Stability

Based on the Finance Oversight Committee's recommendation to the Board from last July, staff have analyzed numerous rate models to determine how the District could adjust the balancing of revenue for fixed and variable costs by restructuring the rate schedule with minimal impact to the

average customer.

With the decline in water usage appearing to continue into the future, the District needs to consider how best to stabilize its revenues. Revenue could be further exasperated by weather or economic downturns, which adds to the need for a more stable revenue structure. For the last couple of years, the Board of Directors has supported the concept of having the Water Availability Rate (base rate) capture more of the District's fixed costs, which has helped to increase financial stability. The 2012 and 2013 rate adjustments were focused on raising the Water Availability Rate, which is not dependent upon water usage. Fixed costs can be defined as those expenses that are incurred regardless of the amount of water used. Variable costs are those more closely tied to the amount of water pumped and delivered.

The larger the percentage of fixed costs that are covered by the Water Availability Rate, the more financial stability is achieved for the District and its customers. While increases to the Water Availability Rate have been made, the Water Availability Rate presently covers about 69% of the District's fixed costs. The opportunity exists this year to make one major restructuring of the District's rate schedule to have the Water Availability Rate capture the significant majority of fixed costs, up to 83%, while balancing the Water Consumption Charges so that the average customer has a minimal increase to their water bill. This overall restructuring of the rate schedule would provide the most expeditious way to achieve additional revenue stability.

The restructuring would be done by balancing both the Water Availability Rate and the Water Consumption Charges so that the average customer would have less than a \$1.00 change to their water bill. For Metro Main and Hub, the Water Availability Rate would be increased from \$22.00 to \$27.00 but the first tier for the Consumption Charges would decrease from \$2.00 to 99¢ per 1,000 gallons and the second tier would be lowered from \$2.70 to \$2.66 per 1,000 gallons. This means that an average customer using 8,000 gallons would only have a difference of 80¢ for their monthly bill.

Proposed Rate Schedule – Residential 5/8” Meter Metro Main & Metro Hub Effective July 1, 2015
Water Availability Rate \$27.00 (currently \$22.00)
Water Consumption Charges 1st Tier (0 - 4,000 gallons) 99¢ per 1,000 gallons (<i>currently \$2.00</i>) 2nd Tier (4,001 - 11,000 gallons) \$2.66 per 1,000 gallons (<i>currently \$2.70</i>) 3rd Tier (11,001 - 18,000 gallons) \$4.30 per 1,000 gallons (<i>currently \$4.21</i>) 4th Tier (18,001 - 25,000 gallons) \$5.70 per 1,000 gallons (<i>currently \$5.62</i>) 5th Tier (over 25,001 gallons) \$7.02 per 1,000 gallons (<i>currently \$7.02</i>)

Metro Diablo Village and Metro E&T service areas have had different rate structures since they were acquired in December 2009. To ensure revenue stability for each of these service areas, rate adjustments are also proposed. In addition, it is proposed that both services areas have the same five tiers for Water Consumption Charges as the other District service areas in order to promote the efficient use of water. Metro Diablo Village currently has no tiers and Metro E&T has three tiers. Their respective Water Availability Rate and Water Consumption Charges including the addition of tiers were adjusted so the average customer in those service areas would also have less than \$1.00 change to their monthly bills.

No change is proposed for Metro Lazy B service area since its current Water Availability Rate is \$30, which is higher than the proposed rate adjustments for all other service areas.

Other Proposed Adjustments

In reviewing the rate schedules for the service areas and the various fees, the General Manger and the Chief Financial Officer recognized an opportunity to revisit different factors used to calculate the rate structures and the additional fees.

Since 1992, American Water Works Association's (AWWA) standards have been applied to the meter equivalencies and used to factor the District's rates and fees. It appears that inconsistencies developed over time in the application of those AWWA standards. The proposed rate and fee adjustments for July 1, 2015 are realigned to match AWWA standards.

Water Service Connection Fee

The District charges a water service connection fee to new customers purchasing a meter and connecting to the system. The water service connection fee is actually the total of three fees including a meter fee, a water resource fee, and a system development fee. These fees have not been adjusted for a number of years. Staff revisited each one to ensure that they capture their associated costs.

The meter fee reflects the actual cost for the meter and parts needed for installation, along with labor and overhead rates, and also includes administration costs associated with issuing that meter.

The water resource fee is intended to have the new development contribute to the acquisition of the District's renewable water resources to meet its existing and future needs.

The system development fee is calculated using an equity (buy-in) method based upon original cost. Each new connection is buying into the existing water infrastructure, which was constructed by previous ratepayer infrastructure investments, based upon the 5/8" meter equivalent capacity. This ensures that development pays proportionally for the system capacity that it will utilize.

In addition, all customer categories listed for the water service connection fee have been grouped together so that the water service connection fee is based on the appropriate meter size and not customer class.

The water connection fee would be the same for each of the District's service areas.

Water Service Connection Fee (proposed to be effective July 1, 2015)				
	Meter Fee	Water Resource Fee	System Development Fee	Total Fee
Proposed - 5/8" Meters	\$439.53	\$170.66	\$1,761.86	\$2,372.05
Current – 5/8" Meters	\$450.00	\$541.00	\$1,356.00	\$2,356.00

Private Fire Service Line Monthly Fee

The private fire service line monthly fee was adopted in November 2010 to cover non-metered lines used to ensure water is available for fighting fires. The private fire service line is generally associated with commercial and multi-family customers and is an additional fee those customers with a private fire service line have on their water bill. The fee was established using Tucson Water's rates and so this fee has been updated accordingly to remain consistent with Tucson Water derived methodology. In addition, 8" lines have been included for the private fire service line monthly fee.

Inspection Fees

The District has two inspection fees: an infrastructure inspection fee and a backflow inspection fee.

The infrastructure inspection fee is 2.5% of the construction costs for the public system (water mains, fire hydrants, water services up to the meter, etc.). The 2.5% would remain for the infrastructure inspection fee; however, a minimum of two hours of inspection would be applied.

The backflow inspection fee has been increased to match the actual cost to provide the service. It is proposed to be \$95 per backflow device from the current \$25 that was established over 20 years ago.

Plan Review Fees

The District charges fees for design review, plan approval and plan revision or re-approval. These fees have been in place since the 1990s and have never been updated. It is proposed to update these rates to cover the actual time and labor staff utilize to complete these reviews.

Finance Oversight Committee

At its March 23, 2015 meeting, the Finance Oversight Committee reviewed and discussed with staff the proposed adjustments to the rates and fees to improve revenue stability. Committee members suggested increasing the Water Availability Rate higher than what staff proposed so that more revenue is secured and to avoid having to request another rate increase next year. It was explained that this proposed restructuring of the rates is viewed as enhancing revenue stability rather than a rate increase. By having revenue stability strengthened in the rate structure, the District will be better able to justify future rate increases with customers by connecting the increase

with the higher costs that may impact the District such as the increase of CAP or energy rates. Committee members concurred with this approach.

The Finance Oversight Committee voted 8-0 to recommend to the Board of Directors to take the necessary action to adjust the rate structure to better balance revenue generated for fixed and variable expenditures as presented by staff at the Committee's March 23, 2015 meeting. Individual Committee members noted that improving revenue stability between fixed and variable costs is wise and were pleased to see the District move in this direction.

The Finance Oversight Committee also voted 8-0 to recommend to the Board of Directors to adopt the adjustments to the water service connection fee, private fire service line monthly fee, inspection fees, and plan review fees as presented by staff at the Committee's March 23, 2015 meeting.

Scheduling a Public Hearing

Based on the Finance Oversight Committee's recommendations, it is recommended that the Board of Directors consider for this year making the recommended rate adjustment to balance revenue for fixed and variable expenditures as well as consider the recommended fee adjustments. This would involve scheduling a public hearing to allow for the public to provide comments to the Board on the proposed change. If the Board does want to schedule a rate hearing, it is recommended that an insert outlining the proposed changes in the rate adjustment be sent with the bills prior to the actual hearing date, as has been done before with previous rate adjustments. It should be noted that what is presented in the insert to customers prior to the public hearing does not obligate the Board in any way since the Board can always approve a variation of its recommendation at the public hearing after receiving public comment. However, it does provide customers with a general idea of what the Board is considering. To accomplish having an insert sent to customers, along with other notification requirements for a hearing, it is recommended that the hearing be scheduled for May 18, 2015 and that any approved rate adjustment become effective July 1, 2015. Staff would prepare a separate insert for Metro Southwest – Diablo Village and E&T service areas since their rate structures have some variation from Metro Main and Metro Hub's rates.

In addition to the public hearing, staff is proposing an information meeting be held on May 13, 2015. This would be similar to the information meeting held last year when the Board was considering an increase the Water Resources Utilization Fee, which was well-received by those who attended. The information meeting would be similar to an open house overseen by staff rather than as a special meeting of the Board. While the public obviously has an opportunity to provide comments to the Board at the public hearing, the information meeting would allow customers to ask whatever question they might have regarding the District's rates and finances in a less formal venue than a public hearing. This information meeting will let District residents gain a better understanding of the District and better formulate their comments that they may want to make at the public hearing. The insert sent to customers regarding the public hearing would also invite customers to attend the information meeting.

Recommendation

It is recommended that the Board of Directors discuss with staff the proposed rate and fee adjustments recommended by the Finance Oversight Committee. It is recommended that the Board schedule a rate hearing for Monday, May 18, 2015 at 6:00 p.m.

At the rate hearing, the Board would consider a rate adjustment that would enhance revenue stability by balancing revenue for fixed and variable expenditures as described in this report. In addition, the Board would consider changes to the water service connection fee, private fire service line monthly fee, inspection fees, and plan review fees. Any changes to the rate structure would be effective July 1, 2015.

It is recommended that an insert be sent to customers outlining the proposed improvement to revenue stability through adjustments to the rate and fees.

Recommended Motion

I move to schedule a public hearing for May 18, 2015 at 6:00 p.m. for the purpose of discussing and possibly adopting an adjustment to the District's water rates, water service connection fee, private fire service line monthly fee, inspection fees, and plan review fees as described in this report and discussed at this meeting.

Respectfully submitted,

Joseph Olsen, P.E.
General Manager