

**METROPOLITAN DOMESTIC WATER IMPROVEMENT DISTRICT  
2014 WATER RATES & REVENUE ANALYSIS  
JULY 28, 2014**

The District is in a solid financial position to meet the various requirements necessary to ensure water is delivered to its more than 20,000 customers. The purpose of this report is to evaluate how the District can build on its current fiscal standing to remain financially strong for meeting future responsibilities and challenges. The key fiscal issues are to employ more of the District's renewable water supplies and to continue to meet the necessary operation and maintenance of its water systems.

This report recommends how these two issues can be addressed financially by employing the appropriate revenue sources: First, make a modest increase to the Water Resources Utilization Fee, which would include a 20 cent increase this year with no increase the following year. Second, have no rate increase to the Water Availability Rate or Water Consumption Charges this year but during the next year, develop a plan to restructure the rate schedule to increase revenue stability for general operating expenses with minimal impact to the average customer.

**Revenue for Utilizing Renewable Water Supplies**

The District has set the framework to more fully utilize its renewable supplies, particularly its Central Arizona Project (CAP) water allocation. At the April 14, 2014 meeting, the Board approved the timeline to implement Phase I of the CAP Recharge, Recovery, and Delivery System. The timeline ensures that the various pieces for the Project come together at the right time and are financed with minimum impact to District customers. The adopted timeframe is as follows:

***CAP Recharge, Recovery & Delivery System***

***Timeline for Phase I***

Land Acquisition

FY 15	Coordination	\$50,000 to \$100,000 Use the Water Resources Utilization Fee
FY 16	Purchase Property	~\$2,000,000 Use the Water Resources Utilization Fee

Design

FY 17	Select Design Consultant(s)	
	Coordinate crossings and easements	
FY 18	Finish crossing and easements	\$300,000 to \$500,000 Use the Water Resources Utilization Fee
FY 19	35% Design -	
FY 20	100% Design	\$2,000,000 to \$3,000,000 Use the Water Resources Utilization Fee

Construction

FY 21	Construction Begins	±\$30,000,000 Financed
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In addition to providing a realistic, practical schedule for completing a large and extensive project, the time frame allows for a fiscal plan that limits additional debt for the District and minimizes the financial impact to customers. As presented in April, the land acquisition and design work can be financed through the Water Resources Utilization Fee without adding to the District's debt. It allows a specified revenue source to be used to generate funds to cover the land acquisition and design work for the CAP Recharge, Recovery and Delivery System. In addition to this Project, the Water Resources Utilization Fee should be able to cover capital expenditures for utilizing the District's effluent for the Cortaro-Marana Irrigation District Groundwater Savings Facility and to pay for part of the 299 acre-feet of Non Indian Agriculture CAP water designated for Metro Southwest. Therefore, as proposed at the April Board meeting, the following modest increases to the Water Resources Utilization Fee are recommended to meet the targets outlined in the Project's timeline.

Proposed Increases to the Water Resources Utilization Fee		
Calendar Year	Fee Increase	Total Fee Amount
2014	20¢	40¢
2015	no increase	40¢
2016	10¢	50¢
2017	10¢	60¢
2018	10¢	70¢

Following the land acquisition and design work necessary for the CAP Recharge, Recovery, and Delivery System, the construction of the Project would begin in Fiscal Year 2021. The construction will be necessary to finance from the best funding source available. To minimize the impact of this loan on customers, the retirement of \$1.2 million of the District's debt in 2019 and the additional debt retirement of approximately \$1 million bonds in Fiscal Year 2024 with another \$1,800,000 the following year would enable the debt service capacity for the construction debt.

As previously noted, the timeline and financial plan for the Project allows it to move forward by financing it with a specific revenue source, the Water Resources Utilization Fee. In reviewing the District's finances since the three months that the timeline was adopted, this financial plan remains a sound approach for making the CAP Recharge, Recovery and Delivery System a reality with minimal impact to customers.

### **Enhancing Revenue Stability**

While the Water Resources Utilization Fee is to provide financing to utilize the District's renewable water supplies, the District's water rates are the primary revenue sources for financing the day-to-day operations of the District, while the System Development Fees are used for capital improvements. The Fiscal Year 2015 budget closely ensures that expenditures made through the fiscal year are less than or equal to the revenue collected and the available fund balance in the same year. The budget does not cover all the projects that the District identified as important for the system; however, it does keep the District in good financial standing to meet the day-to-day operations and address the current needs of customers. By tightening the overall

expenditures and working within the collected revenue, the District has positioned itself for a stronger future.

The challenge for the District is how to best build on the current strong financial foundation since overall operating expenses are projected to continue to increase and water sales continue to decline. The District could consider traditional rate increases or it could look at how to secure greater financial stability by balancing revenue with fixed and variable costs. The following are general trends anticipated for expenses and revenue.

### *Expenses*

The District's general costs consist of the following: Debt Service, CAP Water Purchases, Salaries & Benefits, Purchased Power, and Other Operating Expenses. The overall operating budget for Fiscal Year 2015 totals \$17,458,643.

**Debt Service** is the largest expense category and is a fixed cost that must be paid no matter how much water is used. This accounts for \$6,503,985 in total debt service for the current fiscal year. Debt service is made up of ten loans including bonds and Water Infrastructure Financing Authority (WIFA) loans. The funds have been used for securing the District's renewable water supply through a CAP allocation, increasing reliability by constructing and upgrading critical infrastructure through two Capital Improvement Programs, and acquiring of the Hub Water Company (1999) and the Thim Water Utilities (2009), and the 10 year financing of the RTA mainline replacement projects, which is covered directly by the County/RTA Waterline Relocation Fee. For the following five years, the debt service will be more than \$6,425,000 annually.

**CAP Water Allocation** is the District's renewable water supply for reducing reliance on groundwater. The District pays to have the 13,460 acre-feet of CAP water allocation (Capital Cost) and also must pay for using the water (Delivery Cost). The Central Arizona Project had significant rate increases the last two years, which made it difficult for the District to fully utilize its CAP water allocation. While CAP projects its rates will have minimal annual increases for the next five years, CAP rates are still volatile due to the possible impacts of the Colorado River drought and uncertainty with associated power costs. In addition, if the District wants to utilize more of its CAP allocation, this line item would be impacted in future budgets.

**Salaries & Benefits** cover the cost of the District's 49 employees, who ensure that all functions of the District are met throughout the year. The major factors impacting this category are the costs for insurance coverage and the changes associated with the Affordable Care Act. A 50% increase was projected for the current fiscal year based upon guidance from the District's insurance broker and significant increases are anticipated annually for the following few years. Increases to Arizona State Retirement System costs also impact higher Salaries & Benefits. As such, the District is projecting a 5% increase to Salaries & Benefits each year.

**Purchased Power** is a primary cost used to pump groundwater and help move it at the District's booster stations. The District has and will continue to take steps to reduce its purchased power costs; however, energy prices will continue to rise in the future as seen by Tucson Electric Power

Company's recent 15% rate increase. The District is planning for a 3% increase in energy costs each year.

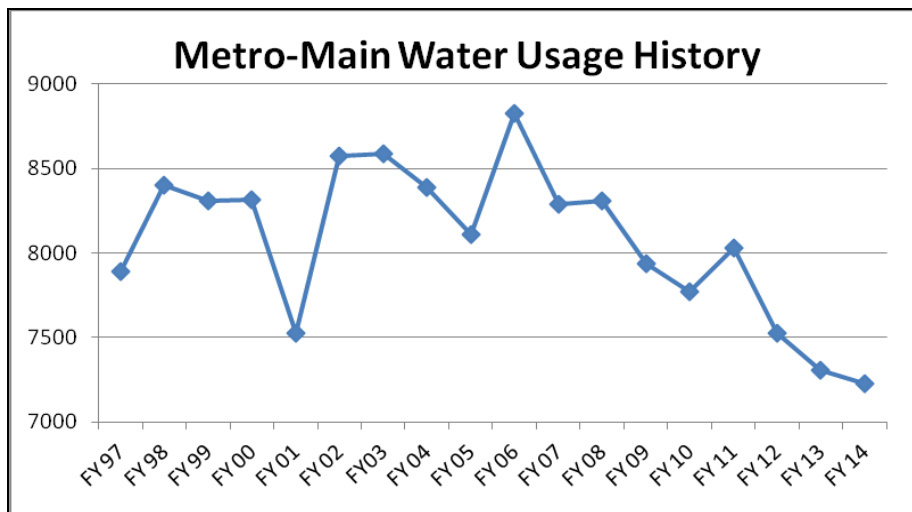
**Other Operating Expenses** include the remaining general operating expenses including supplies and consultant/contract services. The District is anticipating a 2% increase annually to these expenditures.

### **Revenue**

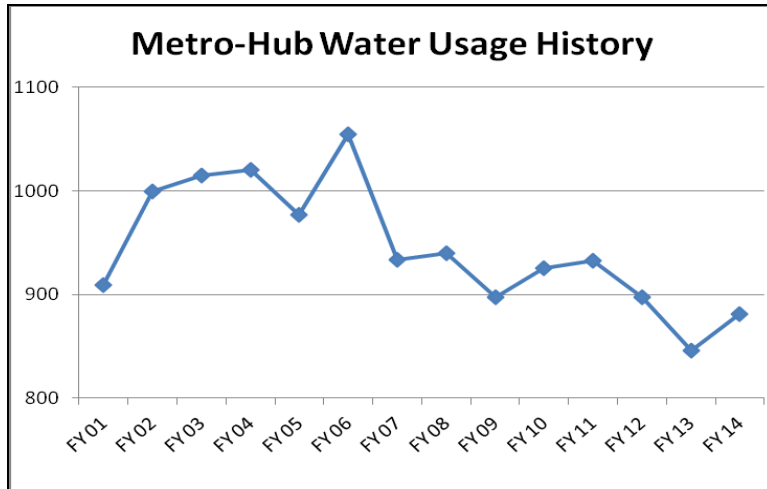
Water sales account for 94% of the District's revenue. The water sales are factored according to the District's rate structure, which includes the Water Availability Rate and the Water Usage Rate and funds the general operating expenses of the District. Revenue from water sales is obviously linked to water consumption.

The District continues to see a decline in water usage that is similar to what is occurring elsewhere in Arizona and across the country. The decline in water consumption is a result of a combination of factors. This includes public awareness of the on-going drought, conservation efforts, decline in growth, and the economic downturn. More importantly, new homes have low water use fixtures and smaller lots sizes for yards, and consumers can now purchase low water using washing machines, dishwashers, and toilets. It is also assumed that Pima County Regional Wastewater Reclamation Department's significant increases to its sewer fees impact water bills, since the sewer fee is collected as part of the District's water bill.

The continued reduction in water usage has been surprising considering recent years with below average rainfall. Metro Main's water usage history continues to decline with less water being used the last three fiscal years than in 2001, which was previously the lowest year for consumption.



At Metro-Hub, 34 more acre-feet of water were used this last fiscal year; however, less water was used the last three fiscal years than the fiscal year following the District's acquisition of Metro-Hub.



A 1.1% decrease in annual water consumption was used to project metered water sales for Fiscal Year 2015. Water sales continue to be monitored closely for any sharp change in the downward trend; however, the 1.1% decrease is calculated to be a realistic projection.

### ***Balancing Fixed and Variable Costs***

With the decline in water usage appearing to continue into the future, the District needs to consider how best to keep its finances stable and strong. Revenue could be further exasperated by weather or economic downturns, which adds to the need to have a more secure revenue structure. For the last couple of years, the Board of Directors has supported the concept of having the Water Availability 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 or Base 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. This is primarily associated with the repayment for capital investments that are made to ensure that a water system will be able to provide water at any time to customers, including peak demand on the hottest day for the year. Variable costs are those more closely tied to the amount of water pumped and delivered. Of the District's total expenses, approximately 52% are fixed costs and the 48% are variable costs.

The more fixed costs are covered by the Water Availability Rate provides the District and its customers with greater financial stability and security. While increases to the Water Availability Rate have been made, the Water Availability Rate presently covers about 70% of the District's fixed costs. The District could continue to adjust the Water Availability Rate by a dollar or two each year to cover more of the fixed costs or the District could make one major restructuring of its rate schedule to have the Water Availability Rate capture the significant majority of fixed costs while balancing the Water Consumption Charges so that the average customer has a minimal increase to their water bill. An overall restructuring of the rate schedule would provide the most expeditious way to achieve revenue stability.

Along with restructuring the rate schedule, realigning the rate adjustments with the development of the fiscal year budget would help with financial plan stability. Best financial practices encourage having revenue decisions such as a rate adjustment made before or at the same time as deciding the financial plan. This would ensure that the financial plan and rates are both in place for the beginning of the fiscal year. District staff would like to work with the Board of Directors and the Finance Oversight Committee during the next year to pursue this financial stability adjustment to the rates in order to give the District an even stronger financial foundation.

### **Recommendation**

The District continues to improve its financial health; however, this report demonstrates the importance of being proactive in analyzing, monitoring, and planning future trends for revenue and expenditures. To accomplish this, the following is recommended:

This year, the District would focus on the Water Resources Utilization Fee and propose a 20 cent increase. No change is recommended to the Water Availability Fee or Water Consumption Charges.

For the next rate setting process, the District would pursue a balancing adjustment between fixed and variable costs for revenue stability by restructuring the rate schedule with minimal impact to the average customer. No increase would be recommended to the Water Resources Utilization Fee.