City of Santa Barbara

Public Works Department

Memorandum

DATE: October 19, 2023

TO: Water Commission

VIA: Joshua Haggmark, Water Resources Manager

FROM: Gabriele Cook, Water Resources Financial Officer

SUBJECT: Introduction to Water and Wastewater Rate Development

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RECOMMENDATION:

That the Water Commission receive a presentation on the development of water and wastewater rates and the initial focus areas for the rate study.

DISCUSSION:

On October 3, 2023, City Council approved a contract with HDR Engineering Inc. (HDR) to update the City's water and wastewater rate models. The City provides water and wastewater services to a population of approximately 95,000, with a service area of 20 square miles. The water system includes a diverse water supply portfolio, treatment, and distribution, with approximately 27,000 service connections. Wastewater service includes sewage collection, treatment, and disposal services to the City's residents. As with most governmental utilities, the City's water and wastewater utilities are dependent on customer rate revenue to fund most of the operations, maintenance, and capital improvements needed to keep the utility functioning reliably, and in compliance with federal and state regulations.

To understand the revenue needs of the water and wastewater utilities, and ensure equity in the rate structure, HDR will review and update the City's rate models, specifically the cost-of-service analyses. These studies will examine all current assumptions, supporting data, and policy points of the existing water and wastewater rate structures, and ensure that proposed rates are compliant with Article XIII D, Section 6 of the California Constitution. This section of California law is commonly referred to as Proposition 218, which was approved by voters in 1996, and includes the requirement that rates may not exceed the estimated cost of providing the service. Staff and HDR will be presenting preliminary information on the following focus areas for the study:

- Protecting public health and the environment through adequate water and wastewater system funding.
- Planning for and projecting future system demands/impacts and attendant infrastructure needs.
- Pacing inflationary cost increases for operating and capital costs.

- Addressing affordability and coordinating with Alliance for Water Efficiency to incorporate their findings and recommendations in the proposed rates, if appropriate.

For more information on water and wastewater rates and fees, visit www.SantaBarbaraCA.gov/water.

ATTACHMENT: Project Scope

Scope of Services

Task 1 – Project Management / Quality Control

This task includes allocating the appropriate labor resources to the project and working with the City's Project Manager to schedule project meetings and provide regular progress reports. As a part of the Study, HDR's Project Manager will provide a monthly progress report with each invoice detailing the status of the Study, status of the project time schedule and budget. Additionally, in accordance with the RFP, HDR's Project Manager will have bi-weekly project meetings with the City's Project Manager to review the project's status and go over timeline adherence, outstanding needs, and general status of the project development.

Internal project quality control is provided as the study progresses. HDR has specific quality control procedures for our projects, and it is the responsibility of HDR's Project Manager to have all project deliverables reviewed via QA/QC process and documented using HDR's standardized QA/QC forms. HDR has designated Kevin Lorentzen to provide QA/QC for this project.

Deliverables from Task 1

- ✓ Coordination with the City's Project Manager
- ✓ Monthly progress report of project status, time schedule and budget
- ✓ Conduct bi-weekly status meetings with City's Project Manager
- ✓ Complete QC/QA procedures for the study

Task 2 –Data Collection

A written data request will be provided to the City prior to the initial project kick-off meeting (Task 3). The written data request will provide a detailed and organized list of the data and information required from each utility to complete the studies. Where some data or information may be difficult, expensive, time consuming, or impossible to provide, HDR will work with the City to resolve the data issues.

Deliverables from Task 2

- ✓ Initial written data request
- ✓ Accumulation and organization of the data by City

Task 3 – Initial Project (Kick-Off) Meeting

An initial project "kick-off" meeting will be held virtually with the City project team. It is proposed that this meeting be approximately 1 hour in length and attended by HDR's Project Manager and assistant Project Manager/Task Lead. The main objective of this meeting is to meet the City's team members, discuss key objectives for the Study, and review the approach/scope of services. This meeting will also allow the City to provide input into the development of the technical analyses and rate alternatives that will be developed for both the water and wastewater utilities. The project schedule will also be finalized at this initial project kick-off meeting. Finally, HDR will also review with the City the initial written data request and review any items that may be difficult to provide.

Deliverables from Task 3

- ✓ Initial project kick-off virtual meeting
- ✓ Approximately one hour in length and attended by the HDR PM and assistant PM/Task Lead

Task 4 – Review of the City's Existing Financial Policies and Benchmarking

Gaining an understanding of the City's water and wastewater financial / rate setting policies is important in laying the groundwork for the Study. HDR will perform a review of the City's existing Council policies as they relate to the utilities and financial planning/rate setting. This review is critical as it provides the policy basis for certain financial planning targets (e.g., minimum reserves, debt service coverage, etc.). As a point of reference, HDR recently assisted the City in the review of reserve policies for the water and wastewater utilities. HDR emphasizes written financial/rate setting policies for two reasons. HDR believes that utilities should be run in a business-like manner, and therefore, should be managed in a financially prudent manner. The other reason for emphasizing this aspect of the process, is that by developing financial (rate-setting) policies, the City is taking a step towards stability in the decision-making process. That is, the policies are adopted based upon prudent financial management of the utilities (industry best practices), and decisions should not necessarily be driven by the politics or timing of the process. The development of written financial policies to establish rates and fees is an industry best management practice. Given that, HDR will review the City's existing water and wastewater financial and rate setting policies and practices and include them in the development of the technical analysis. These policies focus on financial planning issues such as minimum reserve levels, minimum debt service coverage, debt issuance policies, and minimum funding from rates for annual renewal and replacement capital projects. Each of these key financial planning issues appear to be an important component of the City's current financial planning and the development of their 10-year Financial Plans. HDR will review and recommend, as appropriate, additional financial/rate policies for consideration by the City for possible adoption.

The City has also requested a comparison of the current water and wastewater system costs (operational, capital improvement and debt) against appropriate industry benchmarks. To accomplish this, HDR will work with the City to select appropriate performance measures and then compare the findings to industry available resources (AWWA benchmarking, Fitch Medians, etc.). Our findings and results will be presented both numerically and graphically.

Finally, the City has requested that the development of the proposed rates incorporate the findings and recommendations of the Water Affordability and Conservation Assessment study. HDR will work closely with the City and their consultant so that the findings and conclusions from that study are included, as appropriate, in the development of this rate study, the 10-year Financial Plan for each utility, and the final proposed water and wastewater rates of each utility.

Deliverables from Task 4

- ✓ Review the current written financial/rate setting policies of the City and, as appropriate, provide recommended changes or additions to the City's current financial/rate setting policies.
- ✓ Benchmark the current water and wastewater system costs (operational, capital

improvement and debt).

- ✓ Provide a comparison of the current and proposed water and wastewater rates against neighboring agencies, and out-of-area agencies of comparable size to the City.
- ✓ Incorporate into the 10-year Financial Plans and final proposed water and wastewater rates the applicable recommendations from the City's Affordability and Conservation Assessment study.

Task 5 – Revenue Requirement Analysis [10-Year Financial Plan]

The development of the revenue requirement analyses is the first major analytical portion of the comprehensive water and wastewater rate study process. HDR will develop a revenue requirement analysis for each utility using generally-accepted rate-setting methodologies. This portion of the Study entails reviewing the various revenues of each utility and comparing them to the overall expenses. At the same time, consideration should be given to the prudent and proper financial planning, as outlined and discussed in Task 4, including funding for O&M and capital expenditures.

The City, within their RFP, requested the development of a 10-year Financial Plan with a recommended 4-year rate adjustment plan. A more detailed discussion of the steps involved in developing the water and wastewater revenue requirement analysis (i.e., 10 -year Financial Plan) is provided below.

Step 1 – Selection of a Test Period

A "test period" refers to a time frame of reference for the accumulation of revenues, expenses, and other fiscal policy costs (e.g., meeting minimum reserve policy). In this case, the City has requested a 10-year projected time period for the water and wastewater utility, which is similar to recent studies performed by HDR for the City. A projected time period of FY 2024 – FY 2034 (budget year + 10 years) is proposed for both utilities. The use of this projected time period will be discussed with City staff at the initial project kick-off meeting and confirmed.

Step 2 – Method of Accumulating Costs

The next decision is to determine the basis or method of accumulating costs. A "cash basis" methodology is proposed for the revenue requirement analysis which is the same methodology used in prior rate studies that HDR has performed for the City for the water and wastewater utilities. This generally accepted methodology sums operation and maintenance expenses, taxes/transfer payments, debt service, and rate funded (Pay-Go) capital improvements.

Step 3 – Accumulation of Revenues and Expenses

Once the test period and method of accumulating costs has been determined, HDR, in conjunction with City management and staff, will develop the test period revenue requirement analysis for the water and wastewater utilities.

The first step in the revenue requirement analysis is the projection of revenues at present rate levels. Care will need to be taken on the projection of revenues as the City has noted that the City's conservation levels were as high as 40% when compared to 2013 water demands and, more recently, the conservation has varied between 30% - 35%. Given that, HDR will review

recent water consumption history and water billings to develop the assumed consumption levels and profile to base the revenue requirement analyses on. We will work closely with the City to develop a reasonable projection of water sales and resulting water rate revenues. The wastewater billed volumes will be developed in tandem with the water consumption projections. HDR will review recent sewer billings and work with the City to develop a reasonable projection of wastewater volumes and resulting wastewater revenues. Additionally, HDR will review with the City the issue of customer growth and the projection of water and wastewater revenues over the 10-year planning horizon.

The revenue requirement is composed of two major types of costs: operational and capital expenses. The operational costs are generally projected from budgeted water and wastewater costs, using assumed escalation factors, and adjusted for any known changes (e.g., additional personnel, growth/expansion, standards, and regulations). While the projection of the O&M costs is fairly straightforward, the projection and funding of capital costs is generally the focus of the analysis and requires more thought and planning.

The starting point for projecting this City's capital costs (expenditures) will be primarily from the water and wastewater capital improvement plans (CIP). These documents should provide the anticipated capital projects for the projected 10-year period. A significant driver of the study was noted as the development of the capital funding plan to pay for the necessary capital improvements, with additional emphasis on the funding and financing of El Estero electrical distribution system renewal project ($30 million, with debt payments in 2027). HDR strongly believes in a hands-on approach to the analysis and we will work closely with the City to develop a CIP funding strategy that fully funds the capital projects while also balancing the rate impacts to the City's customers. Another important element of the capital funding analyses will be providing consistent annual funding for renewal and replacement projects for the water and wastewater systems. In prior work with the City, this has been referred to as PAY-GO capital and HDR commonly refers to this as "rate funded capital". A minimum annual funding level of at least annual depreciation expense has always been a target of rate studies with the City and will continue to be prioritized as a prudent capital funding approach.

In the financial planning process, consideration must be given to maximizing the funds available for capital expenditures, while minimizing rates. This is accomplished in a variety of ways. However, the most important aspect of this discussion is that there are multiple methods of financing capital expenditures, and it is through this process that the City's water rates can be minimized. Table 1 provides an overview of the general approach that is used to develop a capital improvement funding plan; it is a similar exercise for both the water and wastewater utilities.

Table 1
Overview of the General Methodology For
Reviewing the Financing of Capital Project Expenses

\+ **Total Capital Projects**
- ✓ Renewal and Replacement Capital Projects
- ✓ Legally Mandated Capital Projects
- ✓ System Growth and Expansion Capital Projects

– **Outside Funding Sources**
- ✓ Capital Reserves (System Replacement)
- ✓ Grants
- ✓ Low-Interest Loans (State and/or Federal)
- ✓ Capacity Connection Fees/Contributed Capital
- ✓ Borrowed Funds/Long Term Debt (e.g., Revenue Bond)

= Rate Funded Capital i.e., PAY-GO (≥ Depreciation Exp.)

The basic framework shown in Table 1 is developed on a year-by-year basis in the revenue requirement analysis. In summary form, the general approach is to list the annual capital projects, and then determine the various outside funding sources for each of the projects. The balance of projects not funded by the available sources of funds must be financed from a combination of long-term debt and rates. It is the balancing of the use of long-term debt to the impact upon rates, which is critical to the analysis. As a part of the development of the model, the model will have the ability to quickly show the financial/rate impact of changes in the size or timing of capital projects, funding sources and the use of debt financing. This will be an important tool at the disposal of the City – especially for the wastewater utility – as different funding scenarios can quickly be developed and evaluated for the potential customer bill impacts. Through this iterative process, a final plan can be developed that meets the City's goals for the water and wastewater utility's capital needs, while providing a smooth transition from a financial and rate setting perspective.

In developing the final revenue requirement, a number of financial planning aspects (as noted in Task 4) are also considered. These include, but are not limited to, debt service coverage (DSC) ratios, minimum operating and capital reserves, and annual funding for replacement and upgrade of infrastructure.

Step 5 – Summarization of the Results

At the conclusion of the revenue requirement analysis, HDR will develop a summary page comparing the present revenues to the projected operating and capital expenses for the projected 10-year period of FY 2024 – FY 2034. This will provide the overall cost-basis for any necessary water and wastewater rate revenue adjustments and provide the City with a 10-year Financial Plan and rate transition plan for each utility. As a part of the summarization process, HDR's model will provide meaningful graphics to communicate the conclusions of the revenue requirement analysis.

Deliverables as a Result of Task 5

- ✓ A revenue requirement analysis for the projected 10-year period of FY 2024 – FY 2034, which considers the necessary and prudent operating and capital needs of each utility.
- ✓ Projection of water consumption and wastewater volumes as well as the corresponding revenues to reflect the changing customer demand conditions. Projections will consider the potential long-term changes in customer demands, along with the City's long-term conservation goals.
- ✓ A capital financing plan for each utility within the revenue requirement analyses.
- ✓ Recommendations regarding key financial indicators (debt service coverage, capital replacement, annual target for reserve fund balance, etc.) for the water and wastewater utilities.
- ✓ A half-day project meeting at the City's offices to review the draft revenue requirement analyses attended by the HDR's Project Manager and Task Manager.

Task 6 – Cost of Service Analysis

In simplified terms, a cost of service analysis proportionally distributes the revenue requirement between the customer classes of service of each utility. Traditionally, cost of service principles and methodologies has been the basis for establishing water and wastewater rates that are cost-based, proportional, and legally defendable.[1] The State of California has well-established legal constraints regarding utility ratemaking, of which Proposition 218 (California Constitution Article XIII D) is at the forefront. In short, Proposition 218 requires the water and wastewater utilities to establish cost-based and proportional rates for the services provided.

HDR believes that the principles from past court decisions have a direct impact upon the need to provide clear documentation regarding the cost-basis and proportionality for the City's proposed water and wastewater rates. This includes both the amount of revenue collected from the rates, and also the cost-basis for the fixed and consumption/volumetric rate components. This task is designed to specifically address the requirements of Proposition 218 to provide a cost-basis and proportionality for both the fixed and volumetric components for each customer class of service (i.e., rate schedule) within each utility. A brief discussion of the major steps associated with the proposed water and wastewater cost of service analysis is provided below.

Step 1 – Selection of a Test Year

A cost of service analysis typically reviews a one-year period to establish cost-based rates. For cost of service purposes, allocating the FY 2025 revenue requirements would appear to be appropriate for both the water and wastewater utilities.

Step 2 – Selection of the Method to Accumulate Costs

As appropriate, a "cash basis" revenue requirement will be used for the cost of service analysis for both utilities. This is the approach used in the prior studies completed for the City by HDR for

[1] Generally accepted cost of service principles and methodologies are best defined and discussed within the American Water Works Association (AWWA) M-1 Manual, Principles of Water Rates, Fees and Charges and the Water Environment Federation (WEF), Manual of Practice No. 27, Financing and Charges for Wastewater Systems.

both water and wastewater. At the initial project meeting, HDR will review with the City the current contractual relationships and services provided and develop the appropriate methodology.

Step 3 – Functionalization and Allocation of Expenses

Functionalization refers to the arrangement of cost data into its basic cost categories. For a water utility it is generally source of supply, treatment, transmission, and distribution. For a wastewater utility it is generally treatment, collection, and pumping. The functionalization of costs is typically accomplished within the system of accounts used by the utility. Given functionalized costs, the costs are then allocated to their various cost components based upon the reason why the cost was incurred. For example, allocation determines whether a specific water cost is incurred as a result of a base (average day), extra-capacity (peak day), customer, or a fire-protection-related need. The allocation of the City's water costs will be based upon generally accepted cost of service techniques (i.e., AWWA base/extra-capacity methodology) and the specific system and customer characteristics of the City's water system. The allocation of the City's wastewater costs will be based upon generally accepted cost of service techniques (i.e., WEF MOP #27) and the specific system and customer characteristics of the City's wastewater system. These generally take the form of volume strength and customer-related components for the wastewater study.

The allocation of water sources (resources) to the various customer groups and tiers was a major component of the previous water rate study and will again be an important element of the water cost of service analysis. This allocation has major implications on the pricing of the rate structure tiers, and also on how and what costs are shared. HDR will work with the City to review and discuss the allocations to develop the proposed water rates and tiered pricing. As a part of this portion of the study, HDR will incorporate the applicable findings and conclusions from the City's affordability study and determining where and how to best incorporate those results into this rate study.

Step 4 – Determination of Classes of Service

The cost of service analysis will ultimately distribute the allocated costs for the water and wastewater utilities to the applicable customer classes of service (e.g., residential single-family, residential-multi-family, commercial, industrial, etc.) of each utility. As a part of this task and step, HDR will review with the City the current customer classes of service for each utility and whether modifications or changes are suggested or required. This process will be predicated on the results of analyses performed on customer data together with the input from the City on other policy implications that may be included. HDR will review with the City our findings and conclusions and confirm with the City the appropriate classes of service for each utility for purposes of the cost of service analyses.

Step 5 – Review of Customer Consumptive Use

An important objective of the cost of service is to provide the cost-basis the fixed and variable components of the water and wastewater rates. A cornerstone principle of a cost of service analysis is "those who create the cost should pay for the cost". In the case of the City's water

utility, customer usage (i.e., seasonal use and daily/hourly usage) patterns have operational and cost impacts upon the water system. That implies, for example, that the customer group which creates a peak demand on the system should pay their proportional share of the cost to meet that peak demand. Given that, this step will review the consumptive water data of the City's customer classes of service. This will provide a rational basis for the proportional distribution of extra-capacity related costs.

In the case of the City's wastewater utility, water consumption up to a certain volume of usage (i.e., a defined volumetric cap) is billed and all water consumption usage over and above that is not billed (under the presumption that it is outdoor usage and therefore does not impact the wastewater system). This step will review the volumetric wastewater data of the City's customers and confirm or adjust the billed volume tiers to reflect current usage patterns. This will be accomplished by reviewing average winter water use by customer class of service, along with the total flows at the treatment plant. Another key element of the wastewater cost of service analysis will be the review of the industrial customer loadings to develop cost allocations and rate designs. HDR will work with City staff to review the loadings of high-strength customers, using available sampling data and pertinent research studies.

Step 6 – Distribution of Expenses

The next step is to distribute each of the allocated costs (e.g., base-costs, extra-capacity costs, customer costs, etc.) to the various customer classes of service using distribution factors for each utility. In developing the distribution factors, HDR will develop factors that are proportional and equitable to customers in that they rely upon City-specific data whenever available. The prior step provided the review of customer consumptive behavior which provides the key inputs to the development of flow/volume/capacity related distribution factors.

Step 7 – Summary of the Cost of Service

From the above process, a summary page of the cost of service analysis for each utility is developed. The summary page compares the difference between the current level of rate revenues received from each class of service, and the distributed cost of service for each class of the water and wastewater utility. This provides an understanding of the relationship between the costs each customer class of service places on each system and the revenues received from the customers. From this summary, a determination can be made as to the revenue/rate adjustments, by class of service, which are reflective of cost responsibility.

Step 8 – Development of Average Unit Costs

The cost of service provides the distribution of costs to each class of service, and also provides average unit costs, or cost-based rates. These cost-based rates are used as the starting point for the development of the final proposed water and wastewater rates. Average unit costs also provide the City with an understanding of the cost/rate relationship between fixed and variable cost components.

Deliverables as a Result of Task 6

- ✓ Review of the water and wastewater customer classes of service and determine revisions for cost allocation or rate design alternative purposes.

- ✓ A review of the water consumption and wastewater volumetric characteristics of the City's customers and the impact to water and wastewater rates.
- ✓ A proportional distribution of the water and wastewater FY 2025 revenue requirement to the customer classes for each utility.
- ✓ A summary of the average unit costs (cost-based rates) for both utilities.
- ✓ A half-day project meeting at the City's offices to review the approach, summary, and recommendations of the cost of service analyses. The meeting will be attended by the HDR's Project Manager and Task Manager.

Task 7 – Rate Design Analysis

The starting point for the rate design process is understanding the City's rate design goals and objectives. The City desires rates which are cost-based, provide financial sustainability, conservation/efficiency-oriented, address affordability and equity issues, and meet the requirements of Proposition 218. For both the water and wastewater utilities, the development of the revenue requirement analysis and cost of service analysis was designed to specifically address the issues of adequate funding (current and future), and provide the cost-basis for defensible rates. This includes the basis for the establishment of classes of service, along with both block sizes and pricing of the rate components. This task will focus on developing a simple and acceptable rate structure using the findings, conclusions, and recommendations for the revenue requirement (Task 5) and cost of service analysis (Task 6) for each utility. In addition, the proposed rates will incorporate, as appropriate, the findings and recommendations from the City's Water Affordability and Conservation Assessment study.

As a part of Task 7, the present water and wastewater rate designs (i.e., rate structures) will be reviewed to confirm how well they align with the City's current rate-setting goals and objectives. This will include a review of each of the components of the rate, including the revenue stability/variability of the rate structure. The cost of service analyses for the water and wastewater utilities will have calculated average unit costs, or the cost-basis for each of the proposed rate designs. Included within that analysis is cost information for both the fixed charges and the volumetric charges for each utility.

As a part of this study, HDR will work with the City to develop up to two (2) alternative rate structures for each utility for the City to review and consider. HDR will develop rates for a four-year period, assuming annual adjustments. For each rate design developed, HDR will discuss with the City the advantages and disadvantages of the particular structure. In addition, bill impacts (i.e., bill comparisons) will be developed for each rate design alternative which illustrates and highlights the impacts to customers at various levels of usage. These will be presented in both numerical and graphical format. Finally, comparable utility bill comparisons will be provided to help demonstrate the competitiveness of the City's rates in comparison to other comparable neighboring and water agencies of similar size.

Deliverables as a Result of Task 7

- ✓ Review of the City's water and wastewater rate design goals and objectives.
- ✓ Review of the City's current water and wastewater rates and develop up to two (2) rate design alternatives for each customer class of service.

- ✓ Review of the number of consumption blocks and sizes and basis for the pricing of the City's volumetric rates.
- ✓ Develop bill comparisons and graphs for the rate design alternatives to demonstrate the financial/bill impacts from a change in rates.
- ✓ Develop neighboring utility bill comparisons for comparable water and wastewater utilities.

Task 8 – Written Reports

At the completion of the Study, HDR will develop a draft written report for each utility. The written reports are intended to be comprehensive in nature and document the activities undertaken as a part of the project, along with our findings, conclusions, and recommendations. HDR will provide an electronic version of the draft final reports to the City. The City has specifically requested that the report contain the following items:

1. Brief description of the City.
2. Service area description, including the population served and service area.
3. Brief description of the current water and wastewater classes of service and rate structures.
4. Data on and assumptions of future growth, inflation, and interest rates (i.e., summary of the key assumptions).
5. Brief description of CIP and a ten-year summary of proposed capital expenditures and the funding/financing plan developed for the City.
6. Revenue, expense, and reserve projections over the ten-year timeline (i.e., the 10-year Financial Plan).
7. Summarize the water and wastewater cost of service analysis and the cost-basis for the equitable distribution of costs and pricing tiers used in the proposed water and wastewater rate designs.
8. Rate comparison of existing revenues to meet required needs and a discussion of any recommended rates and inflationary increases necessary to fund future needs of the water and wastewater utilities.
9. Recommended changes to existing City policies, customer classifications, and unit pricing.

HDR will provide an electronic copy the draft reports to the City for its review and comment. Comments, suggestions or corrections from the City, or City legal counsel, concerning the draft report will be incorporated into the draft final reports. At the conclusion of the Study, HDR will incorporate final legal comments from the City's legal review, and final policy direction from the City Council (i.e., adopted rates and rate ordinance). HDR will provide to the City an electronic copy of the final reports. Within our reports, HDR provides an appendix which includes the technical analyses undertaken in order to provide a clear record of the City's rate setting effort and approach.

Deliverables as a Result of Task 8

- ✓ An electronic (word and PDF) copy of the draft reports.
- ✓ An electronic (word and PDF) copy of the final reports.

Task 9 – Public Presentations

As a part of the City's RFP, the City has requested up to five (5) public presentations of the Study. The City, within their RFP, did not fully specify the exact topics for those meetings/presentations. For purposes of discussion only, HDR has assumed the five public meetings/presentations may be structured to review the following rate study issues:

1. Rate study kick-off for the water and wastewater rate setting process ("Rates 101") and review of City financial/rate setting policies with the City's Water Commission
2. Review of the draft water and wastewater 10-year financial plans (i.e., revenue requirements) to the City's Water Commission
3. Review of the cost of service and proposed rate alternatives to the City's Water Commission
4. Presentation of the Study and 10-year Financial Plan to the City's Finance Committee
5. Presentation of the Study and adoption of 10-year financial plan and new rates by City Council (i.e., Prop. 218 Public Hearing)

Based on the above, HDR has included within their labor and fee estimates five (5) public presentations. HDR will develop the presentation materials[2] for these meetings and Shawn Koorn and Josiah Close will make the presentations.

Deliverables as a Result of Task 9

- ✓ Five (5) public presentations to present the City's water and wastewater rate study approach, findings, conclusions, and recommendations.
- ✓ Development of applicable presentation materials based on previously developed technical analyses.
- ✓ Presentations provided by HDR's Project Manager and assistant Project Manager

Task 10 – Financial/Rate Models

As a part of the City's Study, HDR will develop a financial/rate model for each utility. It is proposed that the starting point for this study is to begin with the existing models from HDR's prior rate and financial work with the City, and update/modify the model to reflect the City's current conditions and issues. Our proposed approach allows for improvements to the model and "fine tuning" to address the areas and concerns that may have come up since the last rate studies. This includes the enhancement of any summary tables and/or graphics generated by the model (e.g., cost components of the revenue requirements, trends in reserve balances, CIP, DSC ratios, etc.).

HDR understands that the objective is to design a financial/rate model which is easy for City staff to understand and use. All models will continue to be Excel-based and a copy of the models will be provided to the City at the end of the Study. The City has also requested that HDR train the City staff on the use and understanding of the model. At the conclusion of the study, HDR will provide one (1) day of user training in the use and update of the model. The

[2] The City will be responsible for the development and mailing of the Proposition 218 Notice.

training shall be at the City's offices and accomplished in conjunction with prior in person task meetings at the City.

Deliverables as a Result of Task 10

- ✓ A final copy of the water and wastewater financial/rate models developed in Microsoft Excel.
- ✓ One (1) day of user training at the City's office.

Optional Task 11 – Water and Wastewater Capacity Connection Fee Study

Capacity connection fees are capital recovery fees established as one-time charges assessed against developers or new customers as a way to recover all or a part of the cost of additional system capacity constructed for their use. The objective of these charges is to maintain equity between existing and new customers. In 2021, the City adopted water and wastewater capacity charges with annual adjustments through July 1, 2025 based on the study completed by HDR. As part of this study the City, as an optional task, has requested the review and update of the capacity connection fees.

There are a number of different methodologies which may be used to establish capacity connection fees.[3] The key issue from the perspective of this task is to have a solid foundational understanding of these different methodologies (which HDR does) and then appropriately apply the methodologies based upon the specific circumstances of the utilities (available excess capacity, no excess capacity/expansion needed, etc.). This task will review the City's current water and wastewater capacity connection fees, the methodology used in 2021 to establish them, and then update them to reflect current costs and the appropriate methodology which best reflects the water and wastewater system's current condition and situation.

At the completion of the water and wastewater capacity connection fee review, a written report will be developed to summarize the study's review of capacity connection fee methodology, along with our findings, conclusions, and recommendations. HDR will provide the City with an electronic version of the draft report for review and comment, including City legal review. Comments will be incorporated into a final report and provided to the City electronically. The capacity connection fee models will also be provided to the City at the completion of the Study.

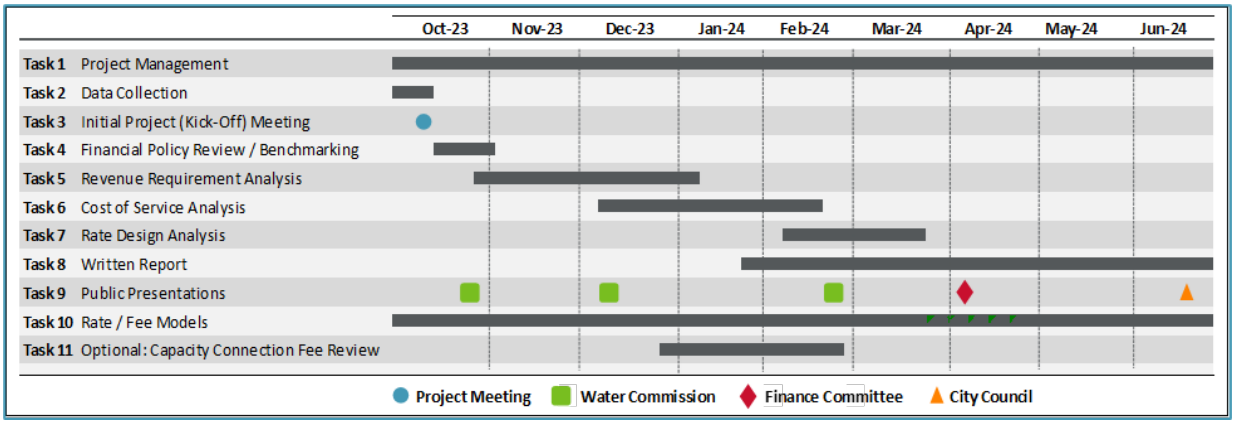
Deliverables as a Result of Optional Task 11

- ✓ Review the City's water and wastewater capacity connection fee methodologies and either confirm the current methodology or recommend appropriate changes/modifications to the methodologies.
- ✓ Review alternative methodologies and recommend the appropriate approach for the City's capacity connection fees.
- ✓ An electronic draft, and final, written report summarizing the findings, conclusions, and recommendations of the capacity connection fee analyses.

[3] For example, there are at least four different methods to value the City's assets. There are also three different methods for calculating the fees: the buy-in methodology, incremental methodology and the combined methodology.

Project Time Schedule

Provided below is a project time schedule to complete the study.



A key element of the time schedule is the ability of the District to provide the data in a timely manner, schedule meetings with appropriate staff, Commission, and City Council. As well as receive policy direction as the study progresses.

Compensation

A detailed fee proposal has been developed for the City's water and wastewater rate and fee studies. Our fee proposal begins with the proposed hourly billing rates by employee classification, and then a detailed fee estimate has been developed based upon the hours, by individual, by task.

Rate Schedule

Our proposed hourly rate schedule, by classification, is provided below. These hourly rate schedules will be in effect during the course of the study. These rates shall apply for the proposed scope of work.

HDR Hourly Rate Schedule

Project Manager	$320.00/hour
Assistant PM/Task Lead	$190.00/hour
Financial Analyst	$125.00/hour
Quality Control/Quality Assurance	$245.00/hour
Engineering Assistance, P.E.	$335.00/hour
Engineering Assistance, EIT	$140.00/hour
Senior Advisor	$395.00/hour
Accounting/Admin	$145.00/hour

The billing rates shown above cover payroll cost, employee benefits, and HDR Overhead and profit.

Expenses

In-House Expenses	
Vehicle Mileage	Current Federal Travel Regulation (FTR)
Black/white Photocopies (per copy)	$0.05 to $0.09
Color Copies (per copy)	$0.15 to $0.30

No markup on expenses. Other direct expenses (e.g., parking, mileage, airfare, etc.) will be billed at cost.

Estimated Project Fee

The project fees are a function of the hourly billing rates for the employees to be utilized on the City's study and the proposed scope of services. Provided on the following page is a summary of the estimated project fees for the services requested by the City.

Summary of the Estimated Fees for the Water and Wastewater Rate Fee Studies		
Task Description		**Total**
Labor:		
Task 1:	Project Management / Quality Control	$8,170
Task 2:	Data Collection	3,280
Task 3:	Initial Project "Kick-Off" Meeting	2,180
Task 4:	Review of the Existing Financial Policies and Benchmarking	11,140
Task 5:	Revenue Requirement Analysis	23,580
Task 6:	Cost of Service Analysis	28,070
Task 7:	Rate Design Analysis	18,460
Task 8:	Written Reports	12,660
Task 9:	Public Presentations	24,170
Task 10:	Financial/Rate Models	1,370
Task 11:	Optional-Connection Fee Study	17,700
Total Labor		**$150,780**
Total Expenses		**$14,815**
Grand Total Study Fees		**$165,595**

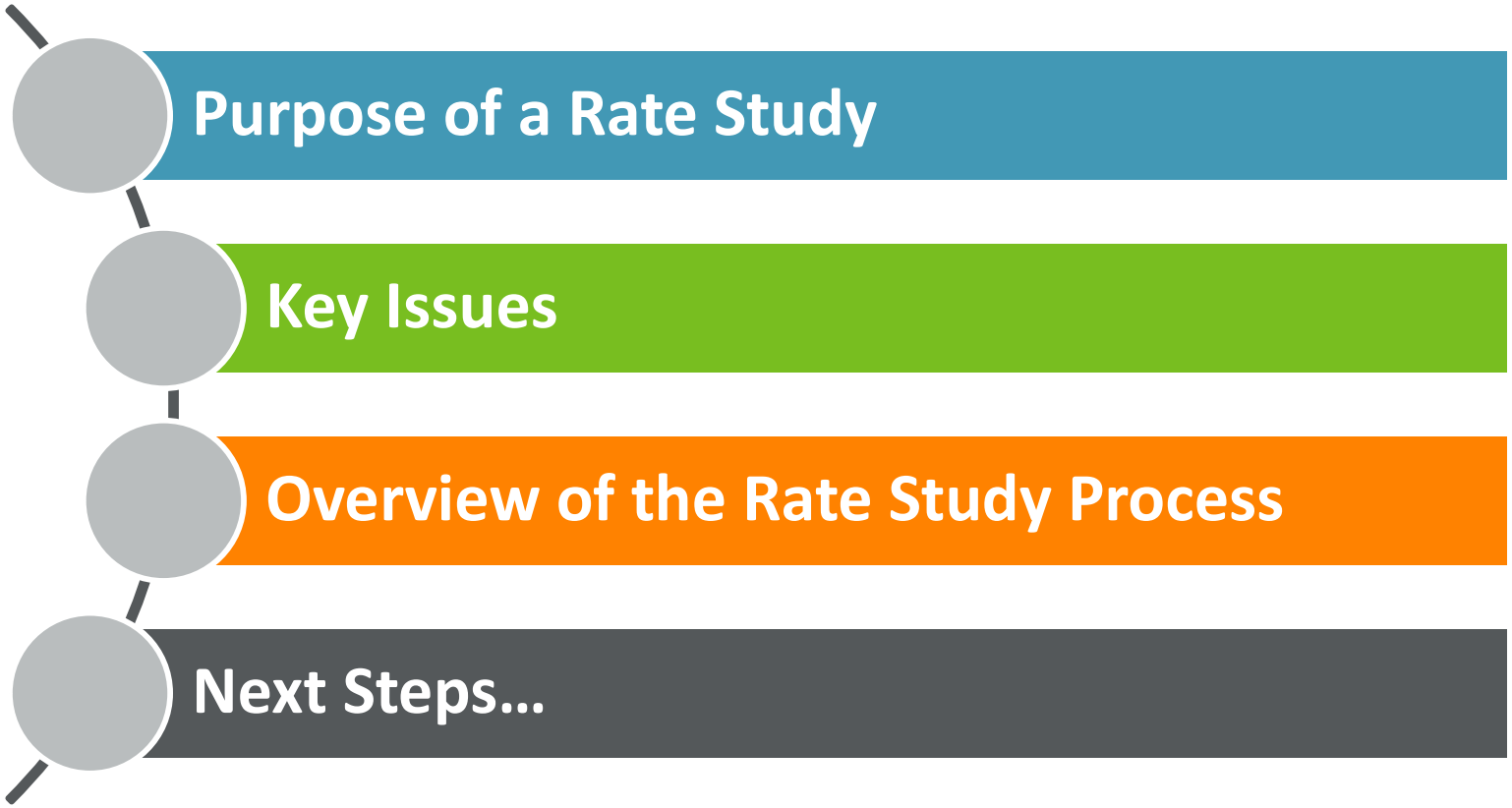
HDR is estimating a total fee of $165,595.00 for the proposed services. In developing the fee estimate, it should be noted for Task 9, Public Presentations are only related to public presentations. All hours associated with internal project meetings are included within the hours of the tasks associated with each of the meetings (e.g., the revenue requirement analysis task [Task 5] contains internal project meeting hours).

Should additional services or public presentation meetings be requested by the City, they will be billed on a time and material basis. No out of scope services shall be provided without the written authorization of the City.

Water and Wastewater Rate Studies

October 19, 2023

Overview of the Presentation



Purpose of a Rate Study

Purpose of a Rate Study

- Provide an adequate level of rate revenue to operate and maintain the City's water and wastewater systems
- Develop cost-based water and wastewater rates
  - Meet requirements of Proposition 218
- Reflect prudent financial planning criteria
  - Maintain target debt service coverage (DSC) ratio
  - Prudent rate funding of capital (Pay-Go)
  - Meet target reserve balances (i.e., Council Policy)
- Develop the study using generally accepted methodologies tailored to the City's system and customer characteristics
  - Water = AWWA M1 Manual
  - Wastewater = WEF MOP #27

A Comprehensive Methodology

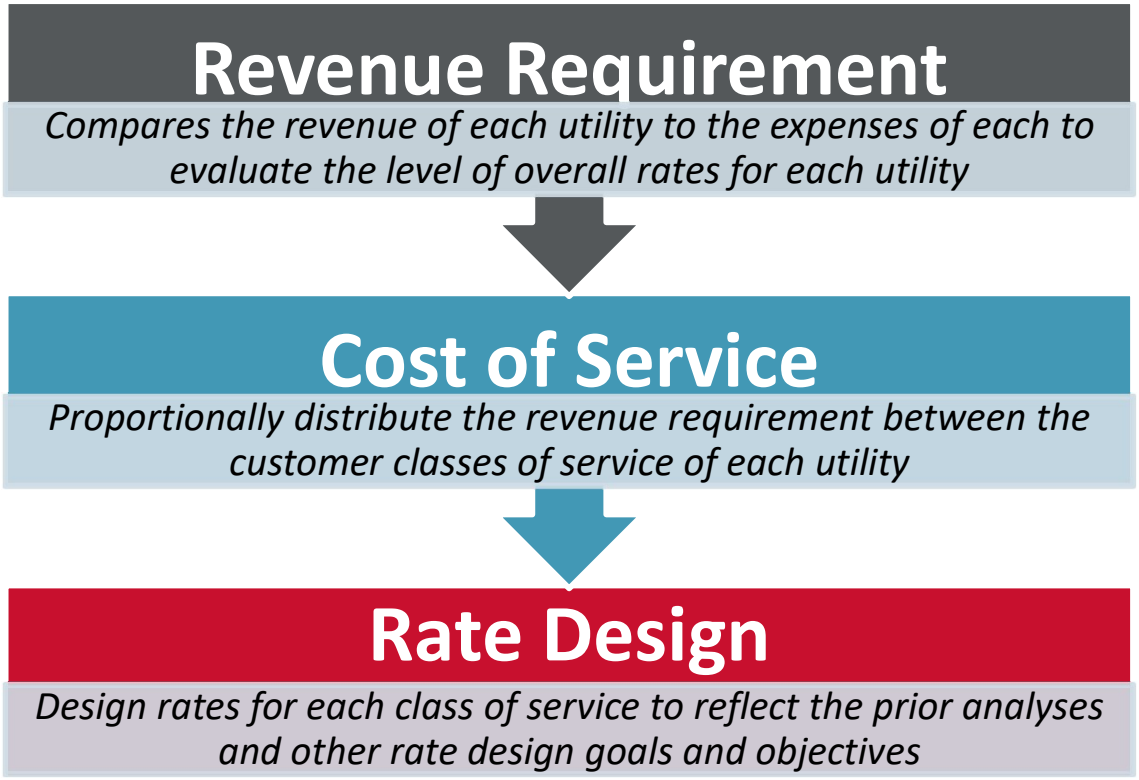
- ✓ **Task 2:** Data Collection
- ✓ **Task 3:** Kick-Off Meeting
- ✓ **Task 4:** Review of the City's Existing Financial Policies and Benchmarking

- ✓ **Task 5:** Revenue Requirement Analysis (10-Year Financial Plan)
- ✓ **Task 6:** Cost of Service Analysis
- ✓ **Task 7:** Rate Designs
- ✓ **Optional Task 11:** Water and Wastewater Capacity Connection Fee Study

- ✓ **Task 8:** Written Report
- ✓ **Task 9:** Public Presentations
- ✓ **Task 10:** Financial / Rate Models

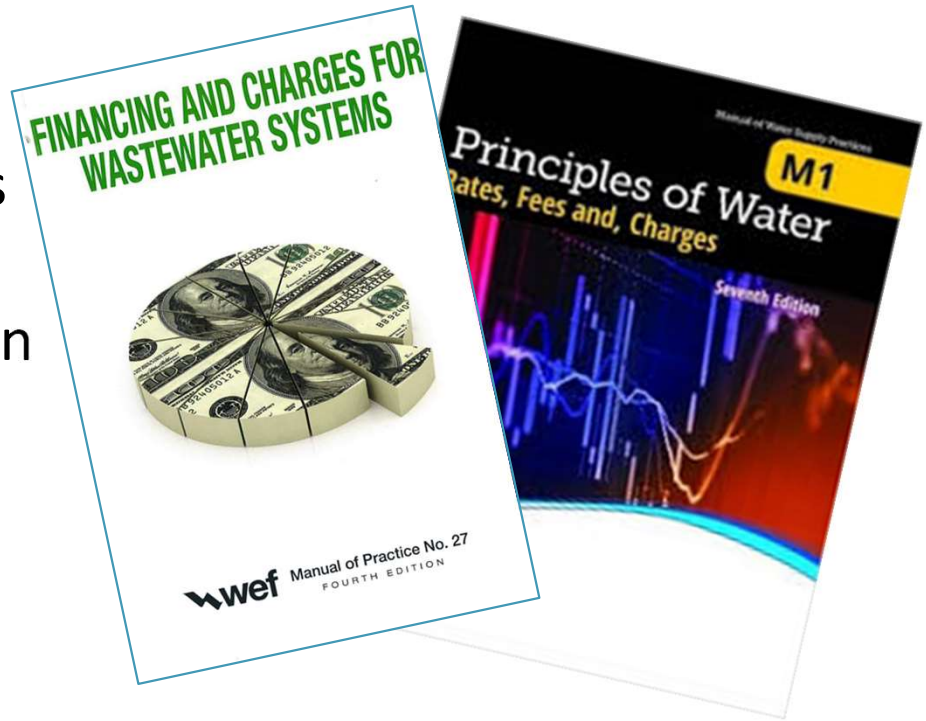
✓ **Task 1: Project Management/Quality Control**

Developing Cost-Based Rates



Key Study Issues

- Cost recovery for water and wastewater utilities
  - Proportional distribution of costs
- Inflationary impacts to O&M expenses
- Increasing cost of capital projects
  - Supply chain, backlog, competition for resources
- Address affordability issues
- Revenue stability and conservation impacts



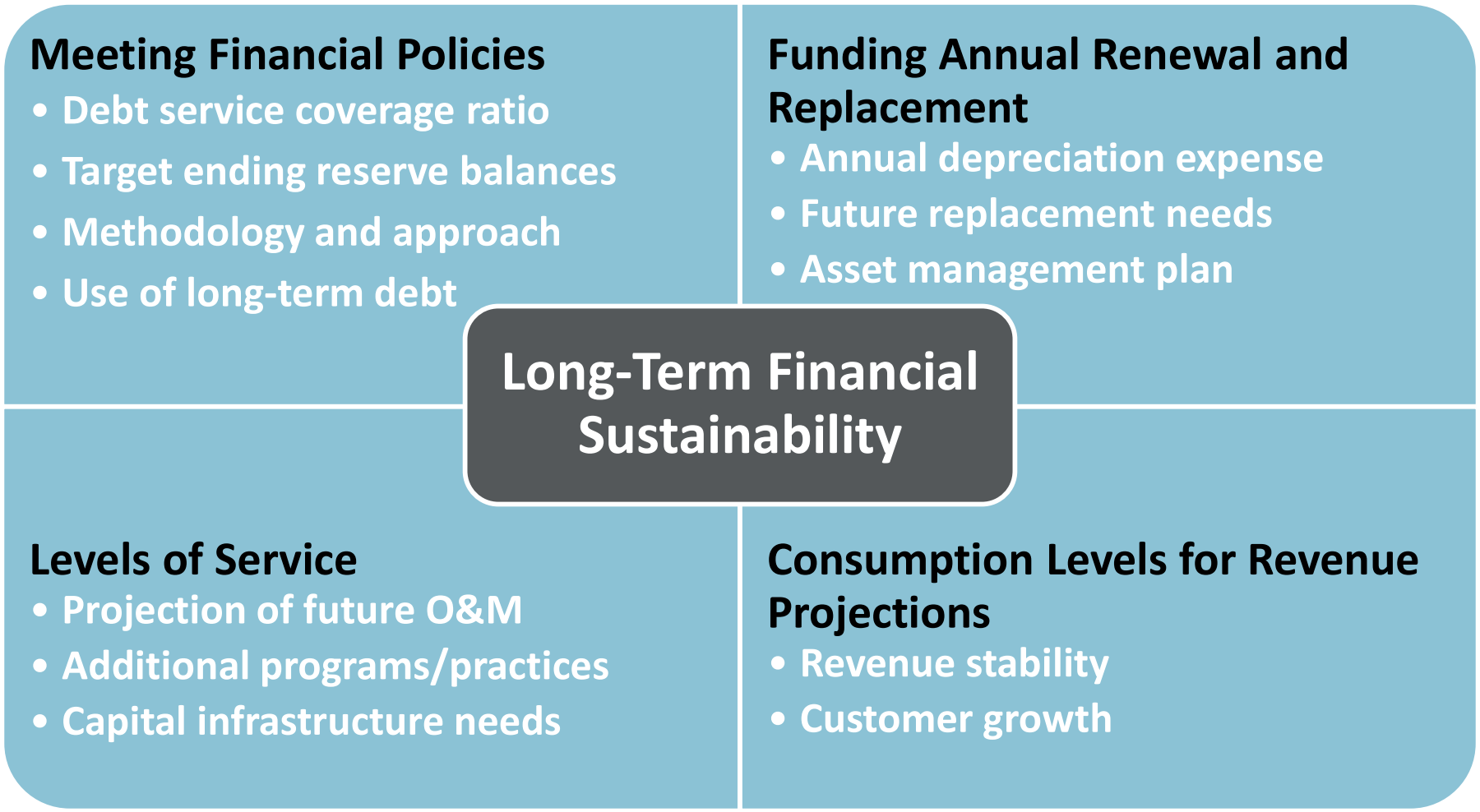
Revenue Requirement

Overview of the Revenue Requirement

Compares utility revenues to expenses	• Determines the level of revenue (rate) adjustment necessary
Uses prudent financial planning criteria	• Adequate funding of renewal and replacements • Maintaining sufficient ending reserve balances
Reviews a specific time period	• Typically, review a five-to-ten-year period • Rate setting is often 2 – 5 years
Utilities is analyzed on a "stand-alone basis"	• No transfer of funds from other City funds • Rates need to support operations and capital
Utilizes the "cash basis" methodology	• Generally accepted method for municipal utilities

9

Revenue Requirement – Policy Discussion



Cost of Service

Overview of the Cost of Service

What is cost of service?

- Analysis to proportionally distribute the revenue requirement to the customer classes of service

Why cost of service

- Generally accepted as “fair and equitable”
- Avoids subsidies
- Revenues reflect costs
- Meet the requirements of Proposition 218

Objectives of Cost of Service

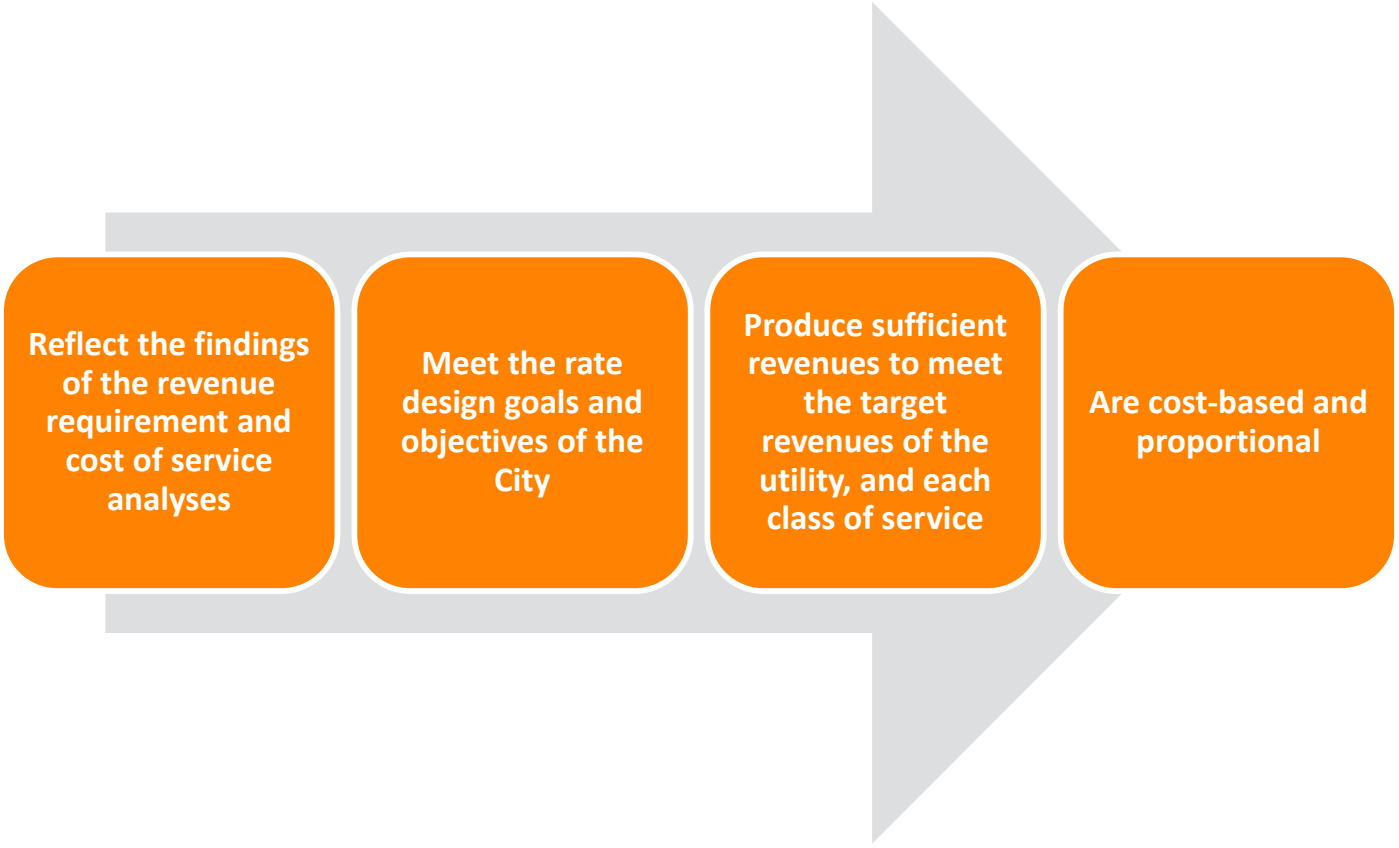
- Determine if subsidies exist
- Develop average unit costs

Summary of the Cost of Service

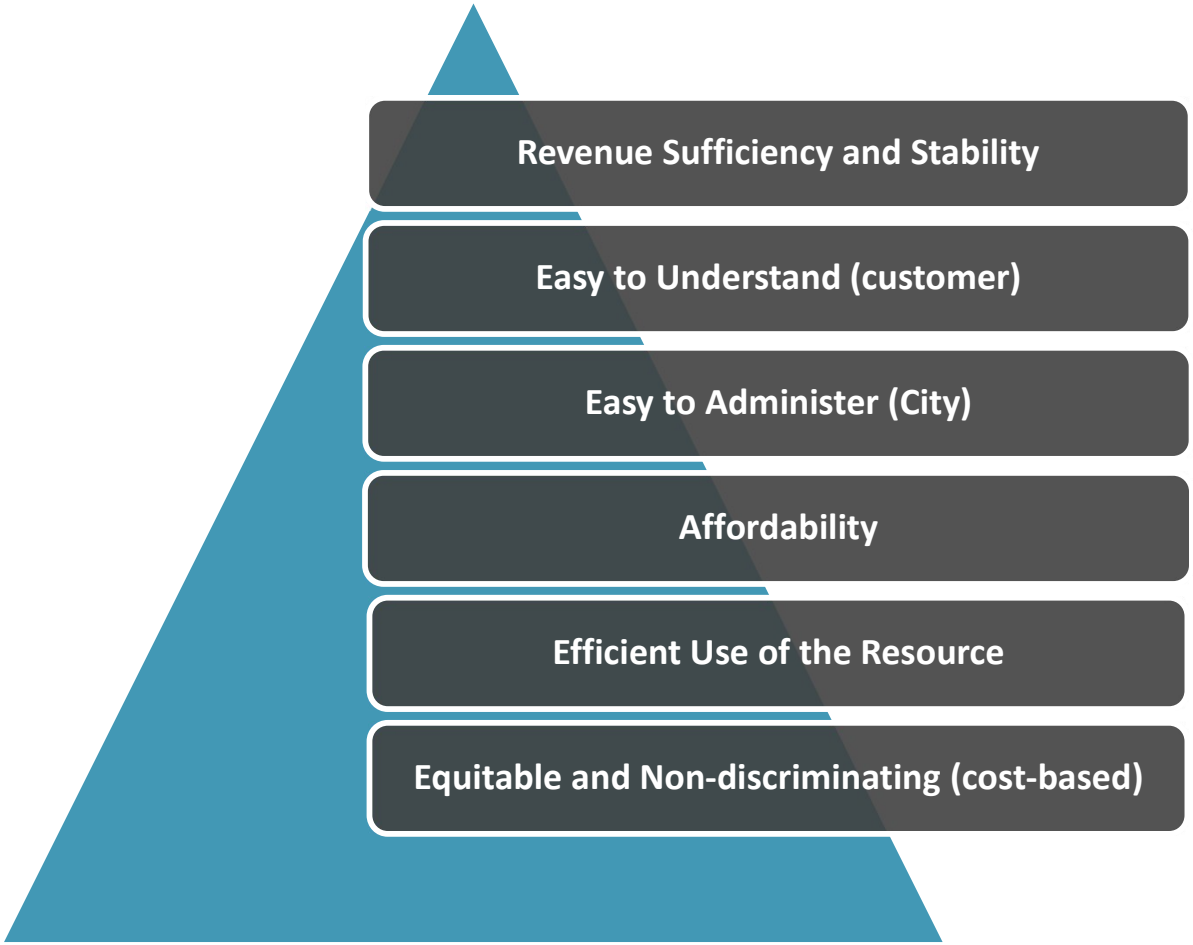
- Reflects usage and facility requirements of each customer class
- Results in proportional rates for each customer class of service
- Provides the City with information for rate structure policy decisions
- City reviews periodically to reflect changes in customer and system characteristics

Rate Design

Overview of the Rate Design



Typical Rate Setting Goals and Objectives



Next Steps

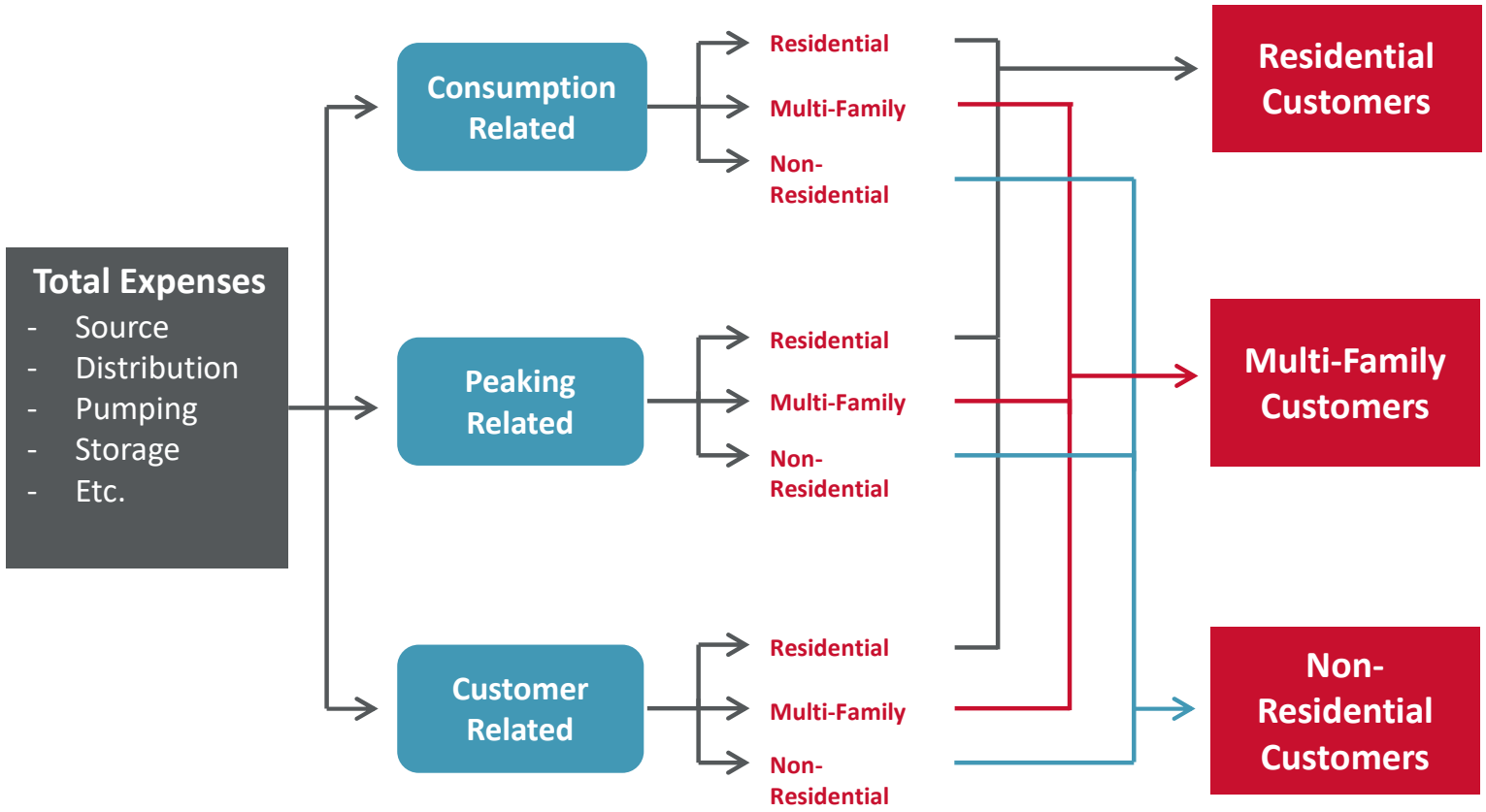
- Draft technical analysis
- Review results and recommendations with staff
- Finalize technical analysis
- Present findings and proposed rates

Schedule

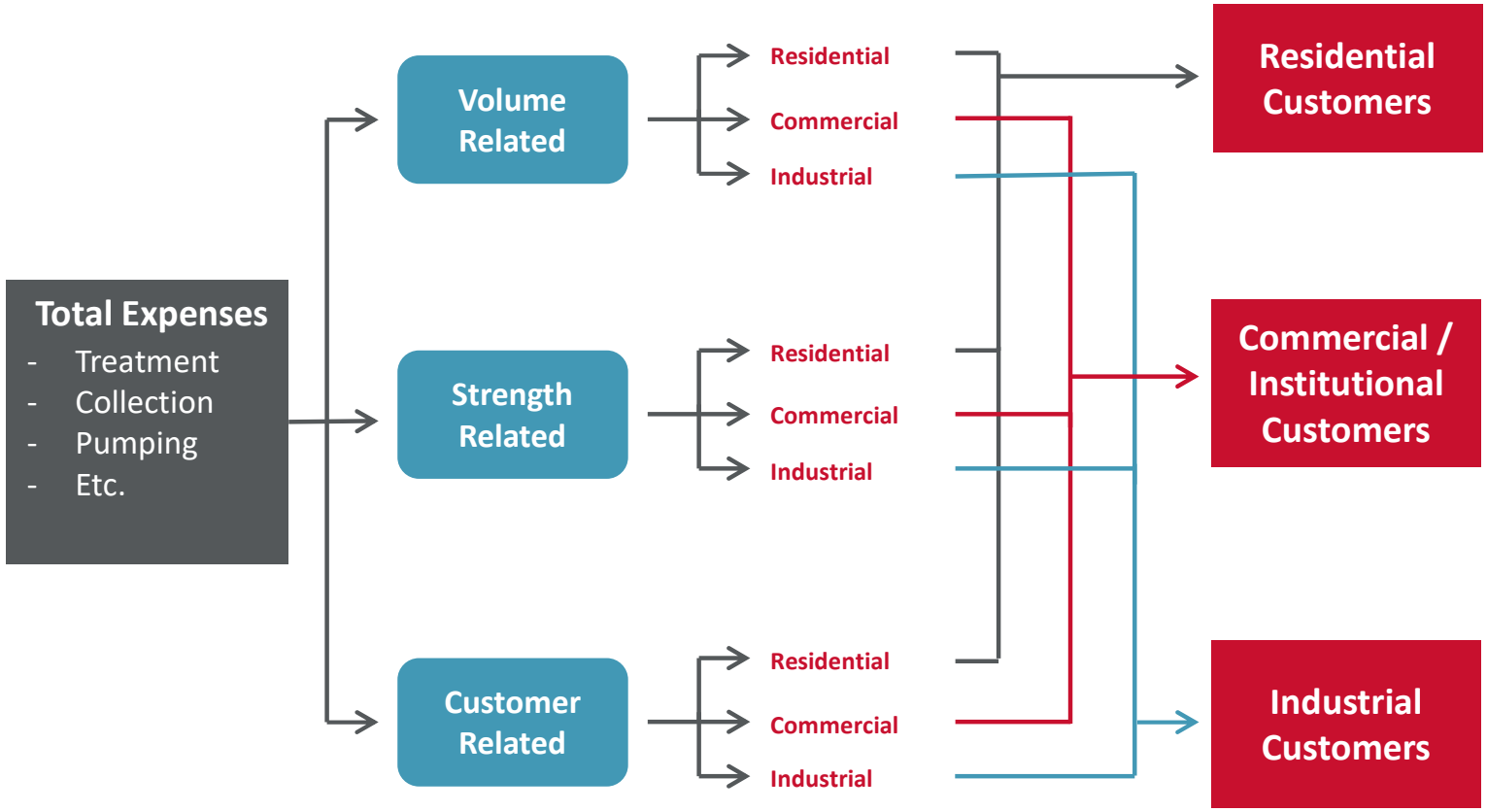
- Jan – Feb 2024: Water Commission reviews draft study results and recommendations
- March 2024: Finance Committee reviews final study results and recommendations
- June 2024: Council holds public hearing
- July 1, 2024: rate implementation

Thank you for your input!

Generic Water Cost of Service Methodology



Generic Wastewater Cost of Service Methodology



Rate Structure Terms Defined

Structure vs. Level

- Rate structure is how the customer is charged
- Rate level is how much revenue is collected

Fixed Charges

- Not based on usage
- Often varies by meter size
- May include multiple "fixed" charges

Variable Charges

- Based on water consumption or wastewater volume / flow
- Commonly charged per CCF or kGal

Utility Cost Structure