TO: **James L. App, City Manager**

FROM: **Doug Monn, Public Works Director**

SUBJECT: **Adoption of Proposed Water Rate Structure**

DATE: **September 2, 2008**

NEEDS: For the City Council to conduct a public hearing, and if there is no majority protest, consider introduction of an ordinance establishing a revised water rate structure.

FACTS:

1. The City hired the firm of Kennedy/Jenks Consultants to thoroughly review the City's costs of providing water service to existing customers and to suggest alternative rate structures to provide sufficient revenues to cover such costs.

2. On July 1, 2008, the City Council considered three alternative water rate structures and selected a combined fixed and variable rate structure as the one to be proposed for adoption. Council also instructed staff to provide the notices required by Proposition 218 regarding the proposed water rates.

3. Notices were mailed to all property owners and water customers on July 2, 2008, explaining the reasons for the proposed water rates and describing the manner in which protests could be filed.

4. On August 19, 2008, City Council deferred action on the adopting the water rate structure and extended the Proposition 218 protest period through September 2, 2008.

5. Proposition 218 requires that a public hearing be held no less than 45 days after the notices are mailed. In order to be valid, a protest must be signed be signed by the property owner or water customer and contain the service address or assessor's parcel number; only one protest may be counted per parcel.

ANALYSIS & CONCLUSION: A thorough analysis of the revenue needs associated with operations of the City's water system for its existing customers has been prepared and is documented in the report entitled "Water Rate and Revenue Analysis Revised Final Report" by Kennedy/Jenks Consultants dated August 27, 2008.

Details about the proposed water rate structure are included in the attached report. In summary, the recommended water rate structure would have both a fixed monthly rate and a variable component, and would provide a tiered structure. The fixed rate component would be based on meter size. Single-family residences use either a 5/8" or 3/4" meter; other uses require larger meters. As shown on the table below, the fixed-rate component for a single-family home would not increase from the current rate of $18 until 2010, when it would rise to $19.98, and gradually increase annually to 2013.

Under the proposed structure, the variable component would depend on the amount of water actually used. Water usage is measured in increments of "hundred cubic feet," or HCF, which equals 748 gallons. For a single-family residence, there

would be one rate for up to 5 HCF and a higher rate over 5 HCF. Currently, a single-family residence pays $1.28 per HCF.

By way of comparison, a single -family residence that uses 30 HCF per month currently pays $56.40 per month ($18.00 fixed rate plus $38.40 for 30 HCF). Under the proposed rate structure, this same household would pay $92.90 in 2009; $143.43 in 2010; and $164.63 in 2011.

The proposed rate structure for all types of usage is depicted in the table below:

Water Rate Structure

Meter Size (inches)	Current Rate	Proposed Monthly Fixed Rates 2009	2010	2011	2012[1]	2013[2]
5/8" & 3/4"	$18	$18.00	$19.98	$22.48	$24.95	$24.95
1"	$18	$25.20	$27.97	$31.47	$34.93	$34.93
1-1/2"	$18	$32.40	$35.96	$40.46	$44.91	$44.91
2"	$18	$52.20	$57.94	$65.18	$72.36	$72.36
3"	$18	$198.00	$219.78	$247.25	$274.45	$274.45
4"	$18	$252.00	$279.72	$314.69	$349.30	$349.30
6"	$18	$378.00	$419.58	$472.03	$523.95	$523.95
8"	$18	$522.00	$579.42	$651.85	$723.55	$723.55
		Proposed Consumption Charge ($/HCF)				
All Customers Except Single Family						
All usage	$1.28	$2.56	$4.22	$4.86	$5.00	$5.15
Single Family Customers						
0-5 HCF	$1.28	$2.18	$3.59	$4.13	$4.25	$4.39
> 5 HCF	$1.28	$2.56	$4.22	$4.86	$5.00	$5.15

Note: HCF = 100 cubic feet, or 748 gallons.

Many factors were taken into account in proposing Paso Robles' water rates and charges. Some noteworthy considerations are:

- Currently, the fixed rate component of the water rate structure is the same regardless of whether a customer has a 5/8-inch meter (as is typical for a single family residence) or a 2-inch meter needed for a business with greater water needs. Much of the water system component sizing and costs relate to delivery

[1] Both the fixed and variable rates would be subject to adjustment on January 1, 2012 by the increase in the Consumer Price Index for All Urban Consumers (CPI-U) for the San Francisco-Oakland-San Jose region as reported by the Bureau of Labor Statistics for the 12 months ending October 31 of the prior year.

[2] Both the fixed and variable rates would be subject to adjustment on January 1, 2013 and each January 1 thereafter by the increase in the Consumer Price Index for All Urban Consumers (CPI-U) for the San Francisco-Oakland-San Jose region as reported by the Bureau of Labor Statistics for the 12 months ending October 31 of the prior year.

capacity, so it stands that customers with higher potential water demand (i.e. larger meters) pay a corresponding higher portion of the share in monthly costs. In keeping with the principle that consumers should pay their fair share of costs, the recommended fixed rate component is higher for larger meters.

- In the past, the City has allowed customers to apply for a "life line" water rate, thus allowing lower income customers to benefit from lower water rates. The proposed rate structure would extend the "life line" lower rate to all residential customers such that the first tier of water use (up to 5 HCF per month) would be delivered at a reduced unit cost. This tiering has the added benefit of rewarding low water use customers for their water conservation success.

- Existing City practice is to provide a credit back to City park/facility and school irrigation in proportion to public usage. Any school that opens its recreational fields for public recreation is eligible for this credit, as is any municipal park or facility. The proposed rate structure would cease this practice and approach City park/facility billings as payable from the General Fund. Sports and event fees will require adjustment to provide a revenue stream for that water billing.

The proposed water rates are proposed to go into effect on January 1, 2009. This implementation date is recommended for the proposed water rates to allow time for required customer notification and to put the new rates into effect during a time of year when usage is traditionally low, thus allowing customers time for a seasonal adjustment.

POLICY REFERENCE: General Plan, Economic Strategy; Urban Water Management Plan; Integrated Water Resource Plan; Nacimiento Water Project Entitlement Contract.

FISCAL IMPACT: The City is contractually obligated to make its share of the debt service payments for the bonds that have been issued to pay for the construction of the Nacimiento Pipeline project. Additionally, one of the facts noted in the Kennedy/Jenks report is that the City has had to draw on reserves to pay for current operations for the last two years because operating expenses have exceeded revenues.

If new water rates are not adopted to pay for the costs of water service the General Fund will, ultimately, have to make up any shortfall. The General Fund pays for operations such as library services, children's and senior programs, parks, as well as police and fire. Serious budget cuts and significant reductions in some services could result.

OPTIONS: a. Close the public hearing and

1. Establish whether sufficient valid protests have been received per Proposition 218 procedures to prohibit adoption of the selected water rate structure.

2. If there is no majority protest, proceed with introduction of Ordinance No. 08-xx and direct staff to schedule September 16, 2008, as the date for reading and adoption of the ordinance.

3. If, there is a majority protest, direct staff to develop alternatives.

b. Amend, modify, or reject the above option.

Attachments

1) "Water Rate and Revenue Analysis Revised Final Report" dated August 27, 2008, prepared by Kennedy Jenks Consultants
2) Ordinance No. 08-xx

Kennedy/Jenks Consultants

2355 Main Street Suite 140
Irvine, CA 92614
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City of Paso Robles
Water Rate and Revenue Analysis
Revised Final Report

August 27 2008

Prepared for

City of Paso Robles
Department of Public Works
1000 Spring Street
Paso Robles, CA

K/J Project No. 0883005

Kennedy/Jenks Consultants

Engineers & Scientists
2355 Main Street, Suite 140
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27 August 2008

Mr. Doug Monn
Director of Public Works
City of Paso Robles
1000 Spring Street.
Paso Robles, California 93446

Subject: Revised Final Report - Water Rate and Revenue Analysis
K/J 0883005

Dear Mr. Monn:

Kennedy/Jenks Consultants is pleased to submit the Water Rate and Revenue Analysis Draft Report to the City of Paso Robles (City). By way of process, we have submitted this final report as a digital ".pdf" file for your distribution as appropriate within the City.

This Rate Study Report is a compilation of the analysis and findings of the City's water fund and incorporates the City's comments and direction obtained from previous draft work products. The results of the study are intended to serve as a plan for future revenue and rate adjustments based on the projected costs and utility water demands.

There are several important factors associated with the performance of the City's water fund that impact the study findings. First and foremost is the need to plan for the funding of the new Nacimiento water supply. The capital, debt, and operational costs associated with the City's transition to this source of supply will continue to place pressure on the City's water rates for several years. Fortunately, it appears that within the five-year planning period, the City's water system cost obligations and associated rate adjustments will have stabilized, positioning the City's water system for long-term financial stability.

It has been a pleasure working with you and the other members of the Rate Study Team on this interesting project and look forward to working with you in the future. Please contact us if you have any questions or need additional information.

Very truly yours,

KENNEDY/JENKS CONSULTANTS

Roger Null, V.P.
Project Manager

Ken Shuey, P.E.
Senior Technical Financial Consultant

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Section 1: Introduction

1.1 Background and Objectives

The City of Paso Robles (City) is a central coast community located in San Luis Obispo County. The City provides commonly sought services, including water and sewer services, to approximately 28,000 residents through 10,000 service connections. To provide a reliable and quality water supply to its customers, the City is now in the implementation phase of a comprehensive long range water system improvement program. Implementation of this program as well as other factors may affect the financial condition of the City's water utility. These factors are:

- The need to assess the future water utility revenue requirements.
- The need to fully implement the financial and operational requirements of the new Nacimiento water supply. These financial obligations include generation of an appropriate level of revenues to pay the annual debt service on the new regional supply pipeline, financing the construction of a proposed water treatment plant to treat the new supply, and funding the increased operating expenses associated with the Nacimiento water supply.
- The need to evaluate the future operating and non-operating revenues and expenses and their effect on the utility's operation.
- The need to fund other capital improvements associated with the City's recent Potable Water Distribution Master Plan and other water system planning projects.
- The need to develop updated rates to fund the projected enterprise financial requirements.
- A need to review and develop an appropriate rate structure to support the water fund's obligations and meet various rate equity and cost recovery requirements.

1.2 Project Scope and Authorization

The City identified the need for a financial evaluation to support the implementation of its long range water system improvement program. As such, the City entered into an agreement with Kennedy/Jenks Consultants on January 15, 2008, to conduct this study to assess the impact of its diversified water supply costs, changing operating expenses, forthcoming debt obligations, and the proposed capital improvement program expenditures. The scope of work for the water rate and revenue study is summarized as follows:

- Perform a financial projection of the City's water enterprise revenue and funding requirements, including the financial impact of future water supply costs.
- Review and develop recommendations regarding appropriate fixed and variable water rates to recover the identified costs.
- Develop a schedule of updated water rates required to meet the financial obligations of the City's water utility.
- Prepare a report of findings that presents the analysis information, conclusions, and recommendations of the water revenue and rate analysis study.

Section 2: Historical and Current Conditions

2.1 Evaluation of Historical & Current Financial Condition

The financial condition of the City's water utility was reviewed and a summary of financial performance is presented in Table 1. The information presented in this table was derived from the City's Comprehensive Annual Financial Reports (CAFRs). The CAFR for Fiscal Year (FY) 06-07 represents the most recent audited financial document of the water utility's financial performance.

The financial condition of a water utility is assessed by contrasting several financial parameters with the financial performance as reported in the City's CAFRs. Foremost among these parameters are criteria for net operating revenues and an assessment of the utility's fund balance. The findings related to each of these elements are provided as follows.

Net operating revenues are an important financial parameter of a utility's performance. This financial parameter is generally desired to be at least 20% of total operating revenues to generate adequate capital improvement funding for new and replacement (depreciation-based) assets. As shown in Table 1, the water utility has historically fallen short of this parameter, in the last three years and there has been a steady decline in operating financial performance. During the three year period, this parameter has ranged from a positive 7% in FY 04-05 to a negative 7% in FY 06-07. In this last fiscal year, the utility fell short of the 20% benchmark parameter by approximately 27%. *As such, the utility currently is not generating sufficient funds to provide for future capital expenditures and increased water utility operating expenses.*

In addition to this operational performance, the impact of various non-operating revenues and capital expenditures is included so that an assessment of the annual ending cash fund balance can be derived. As indicated at the bottom of Table 1, the water fund has experienced a drawdown in cash reserves in the last two years. In FY 06-07, this drawdown was approximately $2.3 million, or 15% of the available water fund balance.

In consideration of these factors, additional revenues from water rates appear to be needed to improve the financial position of the water fund. The following sections of this study provide the supporting information for the level and timing of proposed rate adjustments to meet the water funds current and future financial requirements.

TABLE 1
HISTORICAL OPERATING REVENUES AND EXPENSES

Sources and Uses of Funds	Actuals FY 04-05	FY 05-06	FY 06-07
Operating Revenues			
Charges for Service	3,378,686	3,590,654	$4,312,130
Other	(11,898)	(4,507)	($31,781)
Total Operating Revenues	3,366,788	3,586,147	$4,280,349
Operating Expenses			
Maintenance, Operations, & Administration	2,690,697	3,045,284	$3,721,874
Depreciation and Amortization	452,106	688,798	$841,196
Total Operating Expenses	3,142,803	3,734,082	$4,563,070
Net Operating Income (Loss)	223,985	(147,935)	($282,721)
Net Op Rev as % of Total Op Rev	7%	-4%	-7%
Non-Operating Revenue (Expense)			
Interest Revenue	389,548	489,045	$800,945
Water Connection Fees	NA	1,745,683	$669,578
Nacimiento Water Fees	0	701,862	$573,706
Total Non-Op Revenues (Exp.)	389,548	2,936,590	$2,044,229
Net Income (Loss) Before Capital/Other Costs	613,533	2,788,655	$1,761,508
Net Increase (Decrease) in Cash (a)	$1,221,622	($1,111,385)	($2,275,728)
Beginning Cash and Equivalents	$15,108,839	$16,330,461	$15,219,076
Ending Cash and Equivalents	$16,330,461	$15,219,076	$12,943,348

Source: City of Paso Robles, CAFRs
(a) Includes the integration of capital expenditures and other non-operating costs.

2.2 Current Accounts and Water Demands

As noted in the City's annual report to the Department of Water Resources (DWR), the City provides water service for approximately 10,000 accounts. The City's Calendar Year (CY) 2007 customer information related to general customer types, number of accounts, and water demands are detailed in Table 2. As shown, the majority of these water accounts are represented by base-level residential customers with 5/8" and 3/4" meters.

Also shown in Table 2 is the utility's water consumption data. In CY 2007, the total annual water consumption was approximately 3,305,868 Hundred cubic foot (HCF) and the average consumption per account was approximately 315 HCF per year, or 26 HCF per month (640 gallons per day).

The City's water fund has two primary sources of revenue. These are the sale of water to its customers and the Nacimiento water charge that is assessed monthly to each account. At a current water rate of $1.28 per HCF, the sale of water is estimated to generate approximately $4.23 million per year based on CY 2007 usage. Similarly, applying the $18 monthly fixed charge per account to the City's 10,422 accounts generates approximately $2.25 million per year. Combined, these sources generate approximately $6.5 million per year.

It should be noted that the data in Table 2 has been updated from an earlier draft version of this Water Rate Study. The prior data was derived from an account-level user defined report that apparently did not include all of the City's accounts and some of the associated water consumption. Upon review, the customer characteristics derived in the DWR report appeared to accurately depict the CY 2007 data and has therefore been utilized as the source document for this information in the Final Report. System statistics, as well as the account consumption averages and revenues, have also been updated to reflect these data. A copy of the City's annual report to the DWR for CY 2007 is provided in Appendix A as supporting documentation.

Section 3: Future Revenue Requirements

An evaluation of future revenue requirements can be focused in the projection of four specific areas. These areas are customer growth, water supply costs, capital-related expenditures, and operating costs. The following sections discuss the impact of these factors on the City's water utility revenue requirements over the next five years.

3.1 Projected Customer Growth and Water Sales

Customer growth affects the revenue requirements of the City's water utility in two ways. First, it increases the customer base that is paying for more water usage through the water usage rate, is subject to the monthly service charge, and pays a connection fee to buy into to system capacity. Second, it increases the level of those costs that vary with the quantity of water used such as water supply, treatment, and pumping expenses. In financial planning, applying low to moderate growth factors provides a conservative assessment of future utility revenue requirements.

Based on discussions with City staff, current economic factors suggest a minimal level of additional growth in the next several years. Current growth estimates for the next five years are:

- FY 2008-09 No New Accounts
- FY 2009-10 60 Accounts
- FY 2010-11 100 Accounts
- FY 2011-12 150 Accounts
- FY 2012-13 225 Accounts

In addition to the projection of new account growth, it is also important to project changes in water sales that may affect the utility's financial performance. For the City, foremost among the factors that needs to be considered is the impact of reduced water usage associated with increased water costs and rates. National data indicates the City's water usage will drop as much as 30% as the City implements its new water rates. Based on discussions with City staff, a 25% reduction in water usage is projected herein as this value is comparable to the level of pricing-induced water conservation experienced by other communities. It is further projected that the City's water usage will gradually return to current levels through the addition of new water system customers.

It should be noted that predicting annual growth and water usage can not be derived as precise values. As such, the future growth and water demand values used herein are to be considered as estimates only and are intended to provide a realistic yet conservative forecast of new customers so that connection fee revenues are not overestimated. Similarly, while it can be assumed that water usage should decline with the forthcoming increase in water costs and rates, behavioral changes can not be quantified. Accordingly, the magnitude of future water conservation included in the Water Rate Study is only an estimate used for the purpose of projecting future water sales. All of these factors will be evaluated and integrated in the City's ongoing rate and budget review process to evaluate the financial performance of the City's water fund.

TABLE 2
CURRENT ACCOUNTS AND WATER CONSUMPTION

Customer Type	Metered Accounts	Total Usage (HCF)
Single Family Residential	8,788	1,996,359
Multi-Family Residential	399	307,114
Commercial/Institutional	759	456,430
Industrial	68	73,088
Landscape Irrigation	357	398,077
Other	51	74,800
Water System Totals	**10,422**	**3,305,868**

Source: City of Paso Robles; CY 2007 Department of Water Resources Report

Notes: Metered accounts are the average number of active meters; total usage is the amount of metered water consumption by customer type. Information has been updated from an earlier draft report.

3.2 Budgeted/Projected Operating Expenses

Costs associated with the management, administration, and operations of the City's water utility are contained primarily in two Departments/Divisions. Utility Billing and Cashiering is responsible for the billing, accounting, and administration of the water fund, while Water Production and Distribution is responsible for the operation, maintenance, and management of the water system. The budgeted and projected water utility costs for these Departments are shown in Table 3. These projections are primarily inflation driven, with the integration of some additional costs associated with anticipated future personnel and cost allocation adjustments. The line item detail of these programs as reflected in the City's budget is provided in Appendix A.

In addition to these base-level costs, an additional operational cost assessment is derived to forecast new water fund operation and maintenance expenses associated with the new Nacimiento water supply and with other planned system improvements. As shown in Table 3, water fund operating costs are projected to increase significantly to integrate the new water supply. This cost increase is expected, as the City has proactively determined the need to diversify its water portfolio, and switch from its local groundwater supply to a new high quality/reliable surface water supply. This new supply will be the primary water supply beginning in 2010 and will be supplemented with groundwater as needed to meet then current demand. A summary documentation of the City's water supply plan is provided as supporting information and is also included in Appendix A.

It is important to note that the largest line item in Table 3 is depreciation. While depreciation is a non-cash expense, it does represent the estimated costs associated with the annual wear and tear of the City's assets. Although the City currently does not specifically fund depreciation, it does fund an ongoing local capital improvement program (CIP) that includes specific repair and replacement project costs. As such, a portion of this cost is implicitly recovered in the City's CIP. To proactively plan for this activity, the City should consider integrating the full recovery of depreciation on an annual basis through rates so that adequate funds are available for future capital reinvestment in significant water fund assets. This activity can be accounted for through a new capital repair and replacement program reserve fund. Fund reserves are discussed in a subsequent section of this study.

3.3 Projected Capital Improvement & Debt Service Financing Program

Utility systems are by nature capital intensive operations. To evaluate system capacity and long range water supply reliability, the City has completed several water system studies in the last few years. These documents provided much of the basis for the development and subsequent adoption of the City's 10-year capital improvement program (CIP) for water, wastewater, and other City services.

The City's water system CIP is separated into four basic categories. These are: Nacimiento Water Project Improvements, Well Improvements, Tank/Booster Station/Metering Project Improvements, and Pipeline Improvements. A summary of the five year plan for these project categories is provided in Table 4. A comprehensive listing of the specific projects included in the City's 10-year water system CIP is provided in Appendix A.

TABLE 3

BUDGETED AND PROJECTED OPERATION AND MAINTENANCE EXPENSES

Description	Budgeted FY 2007-08	Budgeted FY 2008-09	Projected FY 2009-10	Projected FY 2010-11	Projected FY 2011-12	Projected FY 2012-13
Utility Billing and Cashiering						
Dept. No. 140 - Division No. 127						
Department Salaries and Benefits	$283,400	$309,300	$318,600	$328,200	$338,000	$348,100
Maintenance - Utilities	$1,300	$1,300	$1,400	$1,500	$1,600	$1,700
Charges from Other Departments	$23,400	$23,100	$23,800	$24,500	$25,200	$26,000
Other Expenses	$282,800	$221,400	$228,000	$234,800	$241,800	$249,100
Subtotal - Utility Billing and Cashiering	$590,900	$555,100	$571,800	$589,000	$606,600	$624,900
Water Production and Distribution						
Dept. No. 310 - Division No. 165						
Department Salaries and Benefits (a)	$929,800	$1,060,185	$1,092,000	$1,124,800	$1,158,500	$1,193,300
Maintenance - Utilities	$940,000	$940,000	$1,021,400	$1,082,700	$1,147,700	$1,216,600
Depreciation (b)	$845,000	$848,000	$1,192,557	$1,751,595	$2,090,812	$2,254,859
Charges from Other Departments	$184,800	$249,500	$347,000	$407,400	$419,600	$432,200
Other Expenses	$928,200	$675,200	$705,500	$726,700	$748,500	$771,000
Subtotal - Water Production and Distribution	$3,827,800	$3,772,885	$4,358,457	$5,093,195	$5,565,112	$5,867,959
Charges to Other Departments	(329,200)	(310,200)	($319,500)	($329,100)	($339,000)	($349,200)
Total Existing O&M Expenses	**$4,089,500**	**$4,017,785**	**$4,610,757**	**$5,353,095**	**$5,832,712**	**$6,143,659**
Forecasted Changes in O&M Expenses for Nacimiento Supply (c)						
New Nacimiento WTP O&M - Estimate			$1,041,000	$2,094,920	$2,220,600	$2,353,800
New Nacimiento Pipeline O&M Costs			$770,866	$1,341,731	$1,341,731	$1,341,731
Changes in Existing O&M Costs (Reductions)			(655,975)	(448,889)	(475,800)	(504,300)
Subtotal New Water Supply O&M Costs			$1,155,891	$2,987,762	$3,086,531	$3,191,231
Allowances for New Water Division Positions		$251,415	$942,671	$970,952	$1,341,918	$1,382,175
Net New Nacimiento Water Supply Costs		**$251,415**	**$2,098,562**	**$3,958,714**	**$4,428,449**	**$4,573,406**
Total New and Existing Forecasted Water Fund Costs		**$4,269,200**	**$6,709,319**	**$9,311,809**	**$10,261,161**	**$10,717,065**

Source: City of Paso Robles Finance Department budget for Department/Division Data
(a) Source: City FY 08-09 Labor Budget adjusted to coincide with forcasted Nacimiento O&M cost estimates.
(b) Source: Table 4 CIP Table, Depreciation Estimate.
(c) Source: TJCross Ops Budget. Values provided have been inflated herein.

TABLE 4

PROPOSED CAPITAL IMPROVEMENT & DEBT FINANCING PROGRAM

Description	FY 2007-08	PROJECTED FY 2008-09	FY 2009-10	FY 2010-11	FY 2011-12	FY 2012-13
Water System Capital Improvement Program (a)						
Proposed Water Treatment Plant		$3,789,830	$19,000,000	$11,400,000	$7,600,000	$0
Well Improvements	$2,796,241	$4,958,500	$1,335,630	$234,848	$247,765	$1,568,352
Tank, Booster Station and Metering Projects	$2,430,940	$2,817,862	$7,058,670	$4,720,450	$24,776	$26,139
Pipeline Improvements	$343,784	$90,673	$557,627	$605,527	$329,803	$823,281
Total Water Fund CIP	**$5,570,965**	**$11,656,865**	**$27,951,928**	**$16,960,826**	**$8,202,345**	**$2,417,772**
Water System Debt Financing Program						
New Debt Issuances (b)		**$43,660,000**	**$0**	**$0**	**$0**	**$0**
Existing Debt						
Nacimiento Water Pipeline Project		$0	$0	$1,587,995	$4,224,589	$4,225,889
Subtotal Existing Annual Debt Service		$0	$0	$1,587,995	$4,224,589	$4,225,889
New Annual Debt Service						
Initial New Debt Service Costs (c)		$0	$0	$0	$2,900,000	$2,900,000
Subtotal New Debt			$0	$0	$2,900,000	$2,900,000
Total Annual Debt Service		**$0**	**$0**	**$1,587,995**	**$7,124,589**	**$7,125,889**
New Total CIP	$5,570,965	$11,656,865	$27,951,928	$16,960,826	$8,202,345	$2,417,772
New Depreciation per Year		$111,419	$233,137	$559,039	$339,217	$164,047
Cumulative New Depreciation Per Year		$111,419	$344,557	$903,595	$1,242,812	$1,406,859

(a) CIP Source: TJ Cross July 2008; Does not include the cost of additional Nacimiento entitlements as its timing is unknown. Captial Facility Charge revenues are included in the financial projection tables as total Water Fund costs are included herein. Comprehensive 10-Year CIP and water supply summary is included in Appendix A.

(b) New Debt Issuances are based on 30 years @ 5% per City staff.

(c) New debt includes the capitalization of interest until FY11-12.

In addition to the CIP, Table 4 also reflects the projected water system debt financing program. Although debt funding of capital expenditures is common among utilities, the City has historically funded most of its water fund obligations from cash. However, in 2007 the City, as well as other regional water purveyors, entered into a contractual obligation with the San Luis Obispo County Flood Control & Water Conservation District to fund a regional water system pipeline project that will convey water from Lake Nacimiento to the City and nearby agencies. The City's proportional share of the debt obligation for this issuance is approximately $4.2 million per year. This debt is schedule to begin in FY 11-12, with a smaller payment due the preceding year. A copy of the comprehensive bond payment schedule is also provided in Appendix A.

To treat this new water supply to drinking water standards, the City must construct a new water treatment plant. The total estimated project costs are projected at approximately $43 million. Similar to the Nacimiento pipeline project, the financing program estimates that approximately $43.7 million in new debt will be needed to fund the construction of this critical facility. Annual debt service payments of approximately $2.9 million are programmed to being in FY 11-12.

It should be noted that funding the construction of the new water treatment plant is vital to the City as it is a cornerstone component of the City's water resources program. Since contractual commitments have been made to procure this new water supply and construct the pipeline, without a water treatment plant, the City will be paying over $5.5 million per year ($4.2 million in debt and $1.3 million in water supply O&M) for water it essentially can not use. Without additional funding and rate-related revenue increases, the new Nacimiento water supply can not be used as drinking water by the City and would have to be discharged into the river. Construction of the water treatment plant needs to begin in 2009 to utilize this valuable water resource.

Lastly, at the bottom of Table 4 is an estimate of the additional annual depreciation associated with the implementation of the capital improvement program. As shown, by the end of the five year planning period, the City's assets will accrue an additional $1.4 million per year of annual depreciation expense. As previously discussed, to account for depreciation funding and expenditures, this funding level should be programmed into an ongoing capital repair and replacement reserve fund.

3.4 Summary of Projected Revenue Requirements

As expected, the City's water fund is projected to experience significant increases in costs to implement the new water supply program. The magnitude of the new debt obligations and increased operating cost associated with the Nacimiento water supply are expected to increase significantly in the next five years to fully implement the City's comprehensive water system improvement program.

A projected revenue plan is developed to compare the water utility's revenues and revenue requirements for the five-year study period. The financial projection is based on the City's projected customer account characteristics, the projected O&M expenses and the inclusion of the City's comprehensive capital improvement program. Additionally, several ratemaking criteria were also integrated in the revenue plan. These key criteria include:

- Growth is conservatively estimated to be flat for the next couple of years, with a modest increase during the balance of the five year planning period. (Refer to Section 3.1.)

- Water sales are projected to reduce by approximately 25% in the first year after implementation of the proposed rates; demands from future new accounts are projected at current levels.

- A new $43.7 million debt issuance is projected in FY 08-09 to fund the construction of the Nacimiento water treatment plant; debt has been capitalized until FY 11-12 to better coincide with additional cash-flow from new water utility customer connections.

- Debt coverage covenants are to be met through utility rates, with additional Connection Fee (Capacity Charge) revenues used to pay down long term debt and fund identified capital improvements.

- Water Connection Fees (Capacity Charges) are based on a 2008 study by HF&H. These fees are designed to increase by the size of the water meter in accordance with published meter capacity ratios and the non-debt service components are scheduled to increase annually at a rate of 5.5%, the projected annual increase in the construction cost index. The proposed fees derived in the Water Capacity Charge study are provided in Appendix A.

- Target water fund reserves have been established based on the sum of the following financial criteria: Operating Reserve – 30% of operating expenses, Economic Uncertainty/ Rate Stabilization Reserve – 20% of Operating Expenses, and Capital Emergency Reserve – one year's average cash-based CIP ($2 million). Additionally, two new funds are recommended to manage and account for ongoing water supply and capital rehabilitation program activity. These funds are: a Water Supply Fund – to be used to account for the acquisition of new water supply rights and a Capital Repair/Replacement Fund – to be used to account for depreciation that is funded and ongoing/projected system renewal expenditures.

A five year revenue plan of the City's water utility is developed by integrating the ratemaking criteria with the projected water system costs and capital expenditures.

3.5 Projected Revenue Requirements Using Proposed Rates

As expected, the results of the revenue plan indicate that additional revenues are needed to meet the current and future obligations of the water fund. Accordingly, a projected revenue plan using proposed rates is prepared to balance the water utility financial obligations and revenues and position the utility for a sustainable positive financial performance. Several cash flow evaluations and alternatives were prepared with City staff to balance financial performance with ratepayer impact. These alternatives varied the debt financing strategies, projected growth scenarios, water consumption levels, rate increase levels/phases, and rate structure elements such as fixed meter and water usage charges so that short term cash flow obligations were met and debt service coverage ratios were sustained above the level required by bond covenants. The resulting revenue plan using proposed rates is shown in Table 5.

TABLE 5
PROJECTED REVENUE PLAN USING PROPOSED RATES

	Adjusted Budget		Projected			
Description	**FY 2007-08**	**FY 2008-09**	**FY 2009-10**	**FY 2010-11**	**FY 2011-12**	**FY 2012-13**
Revenues						
Fixed Monthly Service Charges (As Modeled)	$2,251,152	$3,019,704	$2,709,805	$3,058,166	$3,464,575	$3,721,616
Consumption Charges (As Modeled)	$4,231,511	$3,967,042	$8,469,069	$11,468,871	$12,667,244	$13,378,176
Total Operating Revenues	$6,482,700	$6,986,700	$11,178,900	$14,527,000	$16,131,800	$17,099,800
Operating Expenses						
Department Salaries and Benefits	$1,213,200	$1,369,485	$1,410,600	$1,453,000	$1,496,500	$1,541,400
Maintenance - Utilities	$941,300	$941,300	$1,022,800	$1,084,200	$1,149,300	$1,218,300
Charges from Other Departments	$208,200	$272,600	$370,800	$431,900	$444,800	$458,200
Depreciation	$845,000	$848,000	$1,192,557	$1,751,595	$2,090,812	$2,254,859
Other Material, Services, and Maint. Expenses	$1,211,000	$896,600	$933,500	$961,500	$990,300	$1,020,100
Charges to Other Departments	($329,200)	($310,200)	($319,500)	($329,100)	($339,000)	($349,200)
Net New Nacimiento Water Supply Costs	$0	$251,415	$2,098,562	$3,958,714	$4,428,449	$4,573,406
Total Operating Expenses	$4,089,500	$4,269,200	$6,709,300	$9,311,800	$10,261,200	$10,717,100
Net Operating Revenue	$2,393,200	$2,717,500	$4,469,600	$5,215,200	$5,870,600	$6,382,700
Non-Operating Revenue (Expense)						
Interest Revenue	$85,100	$320,900	$1,167,800	$571,000	$323,500	$237,800
Water Connection Fee Revenues	$0	$0	$1,228,860	$2,761,700	$4,185,689	$6,346,800
Depreciation Adjustment (Non-Cash Expense)	$845,000	$848,000	$1,192,557	$1,751,595	$2,090,812	$1,691,144
Existing Debt Service				($1,587,995)	($4,224,589)	($4,225,889)
New Debt Service (a)					($2,900,000)	($2,900,000)
Total Non-Op Revenues/Expenses	$930,100	$1,168,900	$3,589,217	$3,496,301	($524,588)	$1,149,855
Net Income Before Capital Activity	$3,323,300	$3,886,400	$8,058,817	$8,711,501	$5,346,012	$7,532,555
Capital Expenditures	$5,570,965	$11,656,865	$27,951,928	$16,960,826	$8,202,345	$2,417,772
Capital Financing						
Proposed Debt Issuance		$43,660,000	$0	$0	$0	$0
Subtotal - Capital Financing Issuance Expenses		$7,660,000	$0	$0	$0	$0
Net Change in Funds Avail. After Capital Activity	($2,247,665)	$28,229,535	($19,893,111)	($8,249,325)	($2,856,333)	$5,114,783
Transfer to New Water Supply Fund					$0	$5,682,232
Ending Cash Balance - After Water Supply Fund Xfers	$10,695,683	$38,925,218	$19,032,107	$10,782,782	$7,926,449	$7,359,000
Target Reserve Fund Balance (b)	$4,045,000	$4,135,000	$5,355,000	$6,656,000	$7,131,000	$7,359,000
Development of New Capital Repair/Replacement Fund						
Annual Level of Depreciation Funding						$563,715
Cummulative Fund Balance for Capital R/R Fund						$563,715
Development of New Water Supply Fund						
Annual Level of Funding						$5,682,232
Cummulative Water Supply Acquisition Fund Balance						$5,682,232
Estimated Debt Service Coverage Ratio (Does Not Include Connection Fee Revenues)				4.75	1.16	1.17

(a) Per City staff, Debt is based on 30 years and 5% interest; interest is capitalized until FY 11-12
(b) Target Reserve based on 50% of annual operating expenses (30% ops reserve & 20% economic uncertainty), plus 1-Year's average cash CIP ($2.0 M)

Description	**Proposed Rates and Projected Changes in Accounts and Water Usage**					
Projected Increase in Revs (includes new demand)		**37%**	**51%**	**16%**	**6%**	**5%**
Proposed Fixed Rate Increase		**0.00%**	**11.00%**	**12.50%**	**11.00%**	**0.00%**
Proposed Usage Rate Increase		**100.00%**	**65.00%**	**15.00%**	**3.00%**	**3.00%**
Proposed Fixed Rate ($/Equivalent Meter/Month)	$18.00	**$18.00**	**$19.98**	**$22.48**	**$24.95**	**$24.95**
Proposed Average Usage Unit Rate ($/HCF)	$1.28	**$2.56**	**$4.22**	**$4.86**	**$5.00**	**$5.15**
Proposed Connection Fee (per HF&H, 8-27-08)	$9,119	$15,142	$20,481	$27,617	$27,905	$28,208
Water Conservation Factor	100.0%	75.0%	100.0%	100.0%	100.0%	100.0%
Increase in Number of Equivalent Meters/Year		0	60	100	150	225

As shown in Table 5, double digit rate-based revenue increases are proposed for the next three years so that water utility will generate adequate revenues to meet its increased operating cost and debt obligation in FY 11-12. However, inflationary level increases appear to be adequate in years four and five of the planning periods as the new water supply costs and debt obligations have stabilized. Additional water sales and connection fee revenues are projected to begin to support the water utility's financial obligations in a few years so that the water fund balance is projected to meet target reserve levels beginning in FY 11-12. If growth continues as projected, funds should be available for the acquisition of additional water supply in FY 12-13. These funds will have been generated from connection fee revenues and are to be accounted for in the new water supply fund.

It is recommended that projected rate increases be adopted for implementation in January of each year. While the magnitude of these increases may vary based on unforeseen change in costs, demand conditions, or reserve requirements, these values are projected to provide a reasonable estimate of the projected revenue requirements of the City's water fund for the next five years. As discussed with staff, additional review of the cost components and revenue requirements should be made during the annual budget development and review process. Accordingly the level of the required annual rate increases may differ from the rate and revenue projections derived herein based on those annual findings. A discussion of the City's current and proposed rates and rate structure is provided in the following sections.

Section 4: Current Water Rates

Historically, the City's water rates have been among the lowest in the State, as it benefited from a low cost water supply and purposefully minimized non-essential capital and operational expenditures. As previously discussed, upon completing various comprehensive studies of the City's water supplies and overall water system, the City has embarked on a proactive program to assure the long-term reliability and sustained quality of the City's water system.

Given this need, the City began to increase its water rates to fund the City's capital improvement program including the new Nacimiento water supply program. Additional increases are needed to meet the City's current and projected debt obligations.

The City's present water rates and rate structure went into effect on February 1, 2008. It consists of a fixed monthly service charge that is charged per account regardless of meter size, and a water volume charge that is charged uniformly for all water used by the City's customers. The characteristics of the present rate structure are provided in Table 6 and include:

Current Fixed Monthly Account Service Charge. Pursuant to a 2004 ordinance, the City adopted a fixed charge per account to begin to recover additional revenues for the new Nacimiento water supply. The current fixed monthly charge per account is $18.00, regardless of the customer class.

Current Usage Based Rates. The City's current usage based rates (or variable rates) are applied uniformly to all water usage. Uniform rates are commonly used to recover those costs in a water system that vary with volume of water produced. As such, this rate component correlates a customer's costs of service with the quantity of water consumed and therefore a customer's water bill will fluctuate in direct proportion to the variance in water usage. This usage based rate element supports a fundamental pay for use ratemaking philosophy. The City's current water quantity rate is $1.28 per one hundred cubic feet (HCF), as shown in Table 6.

Low and Fixed Income Lifeline Program. The City currently has a low and fixed income lifeline program in place to provide financial assistance for qualifying single family residential accounts. The current lifeline rate provides a 15% discount on the current volume-based commodity or water usage charge. Eligibility in the program is based on a single-family dwelling unit's participation in Pacific Gas & Electric's (PG&E) or Southern California Edison's (SoCalGas) lifeline programs. Currently, there are approximately 250 lifeline accounts served by the City's water utility.

TABLE 6
CURRENT WATER RATES

Meter Size (Inches)	Monthly Service Charges ($)
Monthly Charges (Fixed Nacimiento Charges)	
5/8" and 3/4"	$18.00
1"	$18.00
1 1/2"	$18.00
2"	$18.00
3"	$18.00
4"	$18.00
6"	$18.00
8"	$18.00
12	$18.00
Usage Charges ($/Hundred Cubic Feet - HCF)	
$1.28 per Hcf for all water usage	

Source: City of Paso Robles
Effective: February 1, 2008

Section 5: Proposed Water Rates

Proposed rates are developed to meet the revenue and rate restructuring requirements of the City's water utility. The proposed rate increases are developed as staged adjustments to both the fixed and variable water rates. To minimize ratepayer impact, annual increases are suggested to be implemented in January of each year, as this is a seasonal period when water usage is at its lowest. A discussion of the City's fixed and variable rates, development of the proposed service and usage charges, development of monthly bills, and a comparison of charges with other communities is provided in the following.

5.1 Fixed and Variable Rate Assessment

An important element of the City's rate structure evaluation is a financial assessment of its vulnerability to short-term revenue shortfalls. Depending on the utility's rate structure and water supply situation, short-term revenue shortfalls can occur during periods of drought, economic downturn, or wet or atypical weather conditions that reduce water sales.

Similar to most water utilities, the City's current rate structure includes a fixed and variable rate component. These rates are designed to provide a fixed revenue source based on the City's active accounts and a variable revenue source based on the amount of water used or consumed by the City's customers.

Fixed costs are defined as any costs that generally do not vary within a year if there is a variation in the level of water demand required. For example, City personnel costs should not vary during a one-year period, although it may vary over longer periods to reflect the level of personnel required to support changes in operating conditions. In contrast, variable costs are those costs that vary with the quantity of water used. Because water systems are capital and labor intensive, total system costs for most water systems are generally recognized as approximately 60 to 75% fixed. It is for this reason that most water agencies throughout the United States utilize a fixed and variable component in its water rate structure.

One method to evaluate the financial health or stability of a particular rate structure is to contrast the nature of the utility's costs with the source of its revenues. This assessment, while not intended to be precise, is developed to provide a framework for utility management decisions related to the balance of fixed versus variable revenues and rate stabilization related reserves. These elements are important because if the fixed and variable revenues are improperly balanced, the utility is financially vulnerable and revenue shortfalls may occur. A summary of the fixed and variable rate assessment for FY 11-12 is provided in Table 7. For this cost assessment, FY 11-12 is used as this fiscal year represents the first year of full debt service water system burden. Current revenues are used to demonstrate the current rate structure's effectiveness at recovering fixed costs and generating usage-based revenues.

TABLE 7
FIXED AND VARIABLE COST/REVENUE ASSESSMENT

Description	Cost Allocation Fixed %	Cost Allocation Variable %	Allocation Results Total	Allocation Results Fixed	Allocation Results Variable
System Expenses/Expenditures			**Costs (FY 2011-12)**		
Capital Expenditure	50%	50%	$602,345	$301,172	$301,172
Debt Service	100%	0%	$7,124,589	$7,124,589	
Operation and Maintenance Expenses					
Department Salaries and Benefits	80%	20%	$1,453,000	$1,162,400	$290,600
Maintenance - Utilities	20%	80%	$1,084,200	$216,840	$867,360
Charges from Other Departments	50%	50%	$431,900	$215,950	$215,950
Depreciation	50%	50%	$1,979,595	$989,798	$989,798
Other Material, Services, and Maint. Expenses	50%	50%	$961,500	$480,750	$480,750
Charges to Other Departments	80%	20%	($329,100)	($263,280)	($65,820)
Net New Nacimiento Water Supply Costs	50%	50%	$3,958,714	$1,979,357	$1,979,357
Total Expenses/Expenditures			$17,266,742	$12,207,576	$5,059,167
Allocation of System Costs			100%	71%	29%
			Revenues (FY 2007-08)		
System Revenues			**Total**	**Fixed**	**Variable**
Nacimiento Fixed Revenues (a)			$2,251,152	$2,251,152	
Consumption Based Revenues (a)			$4,231,511		$4,231,511
Total System Rate Based Revenues			$6,482,663		
Percentage of Fixed and Variable Revenues			100%	35%	65%

Notes: FY 11-12 is used for cost assessment as this represents the first year of full debt service burden; current revenues are used to demonstrate the current rate structure's effectiveness at recovering the percentage of fixed costs.
(a) Based on estimates for FY 07-08, Table 5.