DRAFT
June 26, 2012

TO: Dave Stoldt, General Manager
Suresh Prasad, Admin. Services Manager/Chief Financial Officer

FROM: Thomas Gaffney, Principal

DATE: June 26, 2012

SUBJECT: Monterey Peninsula Water Management District Water User Fee

DRAFT PRELIMINARY WORKING PAPER
MEMORANDUM

We have reviewed the Memorandum prepared by Raftelis Financial Consultants (RFC) dated June 11, 2012 that comments on our Technical Memorandum prepared for the Monterey Peninsula Water Management District (MPWMD) and dated April 12, 2012. We offer the following comments:

RFC observations 1, 2, and 3 all pertain to the amount of revenue the water fee is projected to generate. Our Technical Memorandum is very clear that the water fees are intended to generate an estimated $3.7 million annually. This amount was presented to the District Board and the general public at two public meetings of the District on March 28, 2012 and April 16, 2012 as well as the budget workshop on May 21, 2012. The District has developed a Capital Improvement Plan (CIP) as part of the fiscal year 2012-13 budget showing how the funding will be used. The budget including the CIP is available for review at the District's office. The CIP was presented to the MPWMD Board on April 16, 2012 as a public hearing item and will again be presented on June 27.

RFC states that they cannot comment on the validity of our proposed rate methodology because there is little backup for the basis of the allocations. The basis for the allocations is to collect revenues proportional to historical water use for various customer classes and by using reasonable parameters within each class to individual users. Because the District does not have water consumption information of individual users, some type of other measure is required.

The BWA report discusses in detail various measure that were considered for the basis of the user fee including meter equivalents, lot size, and estimated water use. These methods are employed by many water agencies that do not measure water equity among homes that vary in size from under 1,200 square feet to those over 4,000 square feet. (RFC Methodology Item 3)

Additionally, rates were developed to produce 30% of estimated revenues from meter rates and 70% of revenues from estimated volume. This results in different meter rates for each of the user groups, but the over-all revenue is proportional to the estimated flow of each user group. This allocation method is cost of service based and is recommended as the best management practice by the California Urban Water Conservation Council.

It is industry standard practice to allocate all or a portion of agency revenue requirement to fees based on meter equivalents. As shown in our report, BWA considered apportioning the user fee solely on meter equivalents. This method was rejected as it does not take into account the low water use of some residential customers.

Meters are sized by Cal-Am to accommodate the demand of each connection. The District monitors and manages water supply based on the long-term demand of its customer base. Therefore, water supply is a long-term fixed cost that is appropriately allocated based on meter equivalents. After discussion with the District, meter equivalents of the residential customers were adjusted based on anecdotal evidence that small residential customers use less water than the average residential customer and their consumption patterns tend to fall below their meter capacity. These customers represent lower long-term water supply cost to the District. Medium and large residential customer meter equivalents were then adjusted relative to the small residential customer. In total, the meter charges of all residential customers sum to 30% of the revenue allocated to the residential class. (RFC Methodology Item 5,6,7)

Rates for non-residential properties were developed using and modifying the flat-rate system of the regional wastewater agency. This agency has utilized a flat-rate system for a number of years and the two agencies serve common areas. The vast majority of non-residential wastewater users discharge domestic strength sewage and have minor irrigation use. The wastewater flow of the majority of nonresidential users is roughly equivalent to water consumption (i.e. there is little irrigation use as nearly all water flows into the sewer). The wastewater rate descriptions were modified to include irrigation use for users such as golf courses, parks, and cemeteries. For the majority of nonresidential customers, BWA used the wastewater rate descriptions of Monterey Regional Water Pollution Control Agency (MRWPCA) and the Carmel Area Wastewater District (CAWD). As these

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Memorandum

To: Jeff Massey

From: Sudhir Pardiwala/Hannah Phan

Date: June 11, 2012

Re: Comments on Bartle Wells Associates Technical Memorandum

Kronick Moskovitz Tiedemann & Girard (KMTG) retained Raftelis Financial Consultants, Inc. (RFC) to review the methodology developed by Bartle Wells Associates (BWA) for Monterey Peninsula Water Management District (District) of charging customers of California-American Water Company (Cal-Am). RFC reviewed the BWA Technical Memorandum (Memo) dated April 12, 2012. This memo outlines our findings regarding the methodology proposed by BWA.

In the Memo, BWA calculated the user fee under four alternatives: a variable fee approach, a fixed fee approach based on land use, a fixed fee approach based on meter equivalent, and a hybrid approach. Ultimately, BWA proposed that the District implement the hybrid approach, which has a fixed fee based on meter equivalent and a "variable" fee based on estimated water usage for each property use category.

Based on our review, RFC has the following observations and concerns related to the financial projections.

1. At the beginning of his presentation to the Board on April 16, 2012, the General Manager stated that the $3.7 million was elected because it was the same number historically budgeted to be collected from Cal Am customers. However, historical financial statements showed the District collected less than $3 million per year (as shown in Table 1 of BWA Memo). RFC questions the basis of this number.
2. Our understanding based on documents reviewed is that the previous user fee of 8.325% was suspended by the California Public Utilities Commission (CPUC), of which 7.125% covered the Carmel River Mitigation Program (Mitigation Program). Assuming that the 8.325% user fee collected $3.7 million, the Mitigation Program's portion would be almost $3.2 million. When the CPUC suspended the user fee, the District and Cal Am signed the Interim Mitigation Agreement (Agreement) as a stopgap measure to recover $1.56 million of the Mitigation Program's cost. The Agreement is set to expire in December 31, 2012 so the District will need to enter into a new agreement with Cal Am to recover the costs of the Mitigation Program since according to the General Manager's proposed capital costs, the proposed user fee that will collect $3.7 million does not include the Mitigation Program's expenditure. Based on the District's projections, the costs for the mitigation program would be collected separately from Cal-Am, in

However, the Memo does not give any details about how this was done. Without additional information, RFC cannot comment on the reasonableness of these adjustments.

5. RFC questions the rationale of differentiating meter equivalent charges for different customer classes (SFR, MFR, and non-residential).
   a. Under the hybrid method (shown in Table 21) the proposed single family user fee shows that the meter equivalent factors are different depending on the size of the house. The capacity of the meter depends on the size of the meter, not the size of the house or the type of property associated with the meter. There is no justification provided for differentiating among different classes for the same meter size.
6. The Memo was not consistent in calculating charges per meter equivalent. For instance, the meter equivalent charge did not vary by customer class in the meter equivalent method, but the hybrid method did.
7. Pages 23 and 24 of the Memo stated that *"the fixed cost component is associated with the excess water supply needed to meet peak demand and long-term build-out demand of the Monterey Peninsula. The District does not release water supplies or acquire new supplies based on minor year-to-year changes in demand. Instead, the decision to acquire new supplies is based on long-term analysis of system-wide maximum demand. Meter equivalents are an appropriate metric to collect fixed costs because meter size reflects the maximum (peak) capacity of each meter."* The District's costs relate to water supply; the seasonal or diurnal peak demand of Cal-Am customers does not influence District costs. The allocation of costs to meter equivalent factors is not consistent with cost of service.

This memo outlines our observations and concerns with the methodology proposed in the BWA Memo. RFC would need additional information regarding the basis of estimating water usage for each customer class and the basis of differentiating the meter equivalent ratios for the same meter size between customer classes as well as housing size for single family customer meters before we can comment on the appropriateness and validity of the methodology of the proposed user fee.