



**Date:** March 29, 2017  
**TO:** LOCSD Board of Directors  
**FROM:** Rate Study Working Group  
Rob Miller, Richard Margetson, Ron Munds  
**SUBJECT:** **Agenda Item 7D – Board Meeting Date: April 6, 2017**  
Consideration of Reserve Policies, Revenue Allocations, and Rates for the Water Enterprise Fund

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**DESCRIPTION**

After collaborating with the Financial Advisory and Utilities Advisory Committees, staff is recommending the implementation of revised water rates and reserve policies sufficient to meet the financial obligations of the District, accrue prudent reserves, and provide for the critical capital requirements of the water system.

**SUMMARY OF STAFF RECOMMENDATION**

Staff recommends that the Board adopt the following motion:

***Motion: I move that the Board:***

- 1. Adopt Resolution 2017-11 amending District Reserve Policies relating to the Water Enterprise Fund;***
- 2. Direct staff to implement revised administrative and property tax allocations for future Water Fund budgets as follows:***
  - a. Allocate 80% of the District's administrative cost to the Water Fund***
  - b. Reallocate property tax revenue from the Water Fund to funds with a District-wide benefit in the following percentages: 25% reduction in FY 17/18, additional 12.5% reduction in FY 18/19, and additional 12.5% reduction in FY 19/20, for a total of 50% over three years.***
  - c. Establish the policy that the long-term goal of the District is to reallocate 100% of property tax revenue away from the Water Fund to funds that provide a District-wide benefit.***
- 3. Review and approve the water rate analysis and direct staff to issue the appropriate public notice in accordance with Proposition 218, and set the date of a public hearing to consider a water rate increase***

**DISCUSSION**

In December, 2014, the Board adopted a water rate increase to provide adequate revenue to operate the water system, fund a portion of District administration, and provide for critical capital projects necessary to sustain the District's water supply and address deficiencies within its aging water infrastructure. The rate increase was scheduled to take place over a period of four years, and the following rates were adopted as shown in Table 1, as recommend by the 2014 Rate Study prepared by Bartle Wells Associates (December, 2014). Two of the scheduled rate increases have already occurred.

<b>Table 1: Summary of Previously Adopted Water Rates by Fiscal Year</b>					
		<b>Adopted Water Rates by Fiscal Year</b>			
		<b>FY 15/16</b>	<b>FY 16/17 (current)</b>	<b>FY 17/18</b>	<b>FY 18/19</b>
<b>Fixed Bi-Monthly Service Charge</b>		\$52.36	\$59.32	\$64.64	\$70.42
<b>Water Consumption Charges</b>					
Rate per hundred cubic feet (ccf) per bi-monthly billing period					
Tier 1	0 - 5 ccf	\$2.00	\$2.35	\$2.50	\$2.60
Tier 2	6 – 10 ccf	3.75	4.40	4.80	5.20
Tier 3	11 – 20 ccf	6.00	6.75	7.25	7.80
Tier 4	>20 ccf	8.20	9.20	9.80	10.40
Expected revenue from service charge and water sales from 2014 Rate Study		\$2.1 M	\$2.3 M	\$2.4 M	\$2.5 M

The planned revenues contemplated in the 2014 Rate Study (last row in Table 1) have not been realized, primarily due to a decrease in the number of water units sold. The volume of water sold has decreased by 30% compared to calendar year 2013. As a result, revenues have fallen short of the planned target by approximately \$300,000, which has hindered the District's ability to move forward with critical capital projects. In addition, staff is recommending adjustments in the allocation of administrative costs and property tax revenue that will result in a net additional annual impact to the Water Fund of approximately \$220,000. These adjustments are described in additional detail below.

#### Recommended Adjustments in Administrative Allocation

After consulting with the Financial Advisory (FAC) and Utilities Advisory (UAC) Committees, staff recommends an increase in the administrative allocation applicable to the Water Fund. The current percentage in the adopted FY 2016/17 budget is 62%, resulting in a budgeted expense of \$365,000. Staff recommends that the allocation increase to 80% in FY 2017/18, with a projected amount of approximately \$469,000. This change will reduce the administrative allocation of other funds, with a projected allocation to the Fire Fund of 10%.

#### Recommended Reallocation of Property Tax Revenue

The Water Fund currently receives approximately \$224,000 per year of property tax revenue from the County. This amount changes annually in proportion to the overall assessed value of the property, which has historically resulted in annual increases in the amount allocated to the Water Fund. This revenue is not based on a special assessment or special tax, and therefore it is not separately listed on the County's property tax bill sent to each property owner within the District's water service area. Given that the Water Fund only benefits approximately 50% of the population within the District, the equity of the current structure has been the subject of extensive discussion at the Board and Committee level. It should be noted that the Board has no legal obligation to change the allocation. After reviewing the issue in detail, including the impacts on water rates, the FAC and UAC unanimously recommended that the Board adopt the following two policy positions with respect to property tax revenue:

1. Reallocate property tax revenue from the Water Enterprise Fund to funds with a District-wide benefit in the following percentages: 25% reduction in FY 17/18, additional 12.5% reduction in FY 18/19, and additional 12.5% reduction in FY 19/20, for a total of 50% over three years.
2. Establish the policy that the long-term goal of the District is to reallocate 100% of property tax revenue away from the Water Enterprise Fund to funds that provide a District-wide benefit.

The water rate analysis completed by staff projects revenues and expenses for three years, and includes the assumption that the proposed changes in the administrative percentage and property tax allocation are adopted.

Proposed Water Rates

The 2014 Rate Study included a Capital Improvement Program (CIP) that was adopted by the Board. The CIP included critical water supply projects consistent with the Basin Plan, as well as other high priority projects to address aging or insufficient distribution infrastructure. The minimum annual net revenue required to support these projects is approximately \$500,000 per year, which can then be allocated to various methods of funding projects such as capital reserves, annual pay-as-you-go projects, or additional debt financing. Net revenues are also important to satisfy coverage requirements established by funding entities such as the I-Bank. After reviewing various capital funding scenarios and the associated impacts on rates, the FAC and UAC recommended a three-year rate structure sufficient to fund the District's CIP program in the following amounts:

- Fiscal Year 2017/18: \$500,000
- Fiscal Year 2018/19: \$700,000
- Fiscal Year 2019/20: \$900,000

Staff has assembled a three-year rate structure to accomplish the policies and objectives listed above. The rate structure is intended to provide a higher level of revenue stability compared to the 2014 Rate Study, which is focused more heavily on water conservation. This is accomplished by raising the rates in the lower tiers by a higher percentage than the upper tiers, as well as including increases in the fixed bi-monthly service charge. The proposed rates are summarized in Table 2, and annual projections of revenues and expenses are provided in Exhibit A. Inflation is projected to increase expenses by 3% in future years, and future recycled water revenues are discounted by 10%.

<b>Table 2: Summary of Recommended Water Rates by Fiscal Year</b>					
		<b>Current Rates</b>	<b>Proposed Rates</b>		
			<b>FY 17/18</b>	<b>FY 18/19</b>	<b>FY 19/20</b>
<b>Fixed Bi-Monthly Service Charge</b>		\$59.32	\$65.00	\$70.00	\$76.00
<b>Water Consumption Charges</b>					
Rate per hundred cubic feet (ccf) per bi-monthly billing period					
Tier 1	0 - 5 ccf	\$2.35	\$5.00	\$6.00	\$7.00
Tier 2	6 – 10 ccf	4.40	6.75	7.75	8.75
Tier 3	11 – 20 ccf	6.75	8.50	9.50	10.50
Tier 4	>20 ccf	9.20	10.25	11.25	12.25
Expected net revenues available for capital projects (capital reserve, pay-as-you-go, additional debt service)		N/A	\$500,000	\$700,000	\$900,000

During the discussion of this item, staff will be prepared to display an automated rate model if the Board wishes to see the impact of various rate changes not listed in Table 2. The financial impact to the District's customers will depend on the quantity of water purchased. A common bi-monthly water consumption volume is 12 hundred cubic feet (ccf), which equates to approximately 150 gallons per day. Using this metric, staff has prepared a bi-monthly bill comparison as shown in Table 3. The Golden State Water Company totals are based on a ¾" meter using the rates that will be implemented in April, 2017, according to the company's website. It should be noted that the other communities listed are likely to raise rates in future years, so care should be taken when comparing future LOCSD rates with current rates from other purveyors.

<b>Table 3: Bi-monthly Water Bill Comparison Assuming 12 ccf of Consumption</b>				
Purveyor	Current Amount	Proposed Bi-Monthly Bill Amount (12 ccf)		
		FY 17/18	FY 18/19	FY 19/20
LOCSD based on rates in Table 2	\$107	\$141	\$158	\$176
Golden State Water Company (April 2017 rates)	\$164			
City of Morro Bay (July, 2017 rates)	\$144			
Cambria CSD (with Supplemental Water Facility operating)	\$167 (\$137 without SWF)			
City of San Luis Obispo	\$124			

The District currently charges all users the same bi-monthly fixed charge, regardless of meter size. Morro Bay, Cambria, and the City of San Luis Obispo use the same approach. Golden State changes the fixed charge based on meter size. While staff is not recommending any changes to the current approach at this time, the District could consider varying its fixed charge in the future. Currently, the District has very few residential meters that are larger than ¾".

Staff recommends that the Board enact the motions listed on page 1 of this staff note to enact the policy decisions and rates described above. The text of a proposed resolution to amend District reserve policies consistent with UAC and FAC recommendations is included as Exhibit B. Staff plans to bring back additional recommendations on the Capital Reserve Policy at the June meeting if the rate study is approved by the Board. If the Board chooses to move forward as recommended, staff will begin the process of notifying its customers as required by Proposition 218. Customers will be provided a minimum of 45 days of notice, and a public hearing date will be set for early June to adopt the rates. If adopted, the rates will supersede the previously adopted increases, and will become effective on July 1, 2017.

**FINANCIAL IMPACT**

If the Board chooses to implement staff's recommendations, revenues within the Water Fund are expected to increase over the next three years, with amounts sufficient to fund capital projects in the amount of \$500,000 for FY 17/18, \$700,000 for FY 18/19, and \$900,000 for FY 19/20. The above rate analysis was completed at no cost to the District through the efforts of the rate working group, UAC, and FAC.

**FINANCIAL SUMMARY FOR YEAR 1 - FY 17/18**

<b>REVENUE CALCULATOR</b>					
<b>Water Sales</b>	<b>Totals</b>	<b>Percentage</b>	<b>Rates</b>	<b>Est. Revenue</b>	
Tier 1	74,168	40.7%	\$ 5.00	\$370,840	
Tier 2	47,611	26.1%	\$ 6.75	\$321,374	
Tier 3	35,151	19.3%	\$ 8.50	\$298,784	
Tier 4	25,513	14.0%	\$ 10.25	\$261,508	
<b>Total</b>	<b>182,443</b>			<b>\$1,252,506</b>	
<b>Base Fee</b>			<b>\$ 65.00</b>	<b>\$1,072,500</b>	
<b>Total</b>				<b>\$2,325,006</b>	
<b>Other Revenue</b>			<b># Accounts</b>		
Base Fee w/ no consumption			<b>506</b>	\$32,890	
Property Tax				\$	167,250
Water Service Charges					\$47,000
Recycled Water Revenue				\$	106,229
Other					\$60,000
<b>Total</b>					<b>\$413,369</b>
<b>Require Inputs</b>			<b>TOTAL</b>		<b>\$2,738,375</b>
<b>Recycled Water Revenue Calculator</b>					
	<b>CCF</b>	<b>Revenue</b>			
Tier 1	60	\$ 270			
Tier 2	60	\$ 365	School Irrigation		
Tier 3	120	\$ 918	8,563	Commercial ccf	
Tier 4	11,347	\$ 104,676	3,024	Irrigation ccf	
<b>Total</b>	<b>11,587</b>	<b>\$ 106,229</b>	<b>11,587</b>	<b>Total/yr.</b>	
<b>EXPENSES CALCULATOR</b>					
<b>RESERVES</b>					
	Capital Outlay	see below			
	Rate Stabilization	\$	<b>32,000</b>		
	General Contingency	\$	<b>57,000</b>		
	Designation for Basin Mgt.	In O&M budget			
	Designation for Water Cons.	\$	-		
<b>Restricted</b>	I-Bank Loan	\$	278,000		
	<b>TOTAL</b>	\$	<b>367,000</b>		
<b>GENERAL</b>					
	Capital (Outlay reserve, future debt, pay as you go, Ibank coverage requirement)	\$	<b>500,000</b>		
	Operating	\$	<b>1,400,000</b>		
	Admin Overhead	\$	<b>470,000</b>		
	<b>TOTAL</b>	\$	<b>2,370,000</b>		
	<b>TOTAL</b>	\$	<b>2,737,000</b>		
<b>Require Inputs</b>					
<b>REVENUE VS. EXPENSES</b>		\$	<b>1,375</b>		

YEAR 2 - FY 18/19

**REVENUE CALCULATOR**

Water Sales	Totals	Percentage	Rates	Est. Revenue
Tier 1	74,168	40.7%	\$ 6.00	\$445,008
Tier 2	47,611	26.1%	\$ 7.75	\$368,985
Tier 3	35,151	19.3%	\$ 9.50	\$333,935
Tier 4	25,513	14.0%	\$ 11.25	\$287,021
<b>Total</b>	<b>182,443</b>			<b>\$1,434,949</b>
<b>Base Fee</b>			<b>\$ 70.00</b>	<b>\$1,155,000</b>
<b>Total</b>				<b>\$2,589,949</b>
<b>Other Revenue</b>			<b># Accounts</b>	
Base Fee w/ no consumption			<b>506</b>	\$35,420
Property Tax				\$ 140,769
Water Service Charges				\$47,000
Recycled Water Revenue				\$ 116,657
Other				\$60,000
<b>Total</b>				<b>\$399,846</b>
Require Inputs		<b>TOTAL</b>		<b>\$2,989,795</b>

Recycled Water Revenue Calculator				
	CCF	Revenue		
Tier 1	60	\$ 324		
Tier 2	60	\$ 419	School Irrigation	
Tier 3	120	\$ 1,026	8,563	Commercial ccf
Tier 4	11,347	\$ 114,888	3,024	Irrigation ccf
<b>Total</b>	<b>11,587</b>	<b>\$ 116,657</b>	<b>11,587</b>	<b>Total/yr.</b>

**EXPENSES CALCULATOR**

RESERVES		
Capital Outlay		see below
Rate Stabilization	\$	<b>32,000</b>
General Contingency	\$	<b>57,000</b>
Designation for Basin Mgt.		In O&M budget
Designation for Water Cons.	\$	-
<b>Restricted</b>	I-Bank Loan	\$ 278,000
	<b>TOTAL</b>	<b>\$ 367,000</b>
GENERAL		
Capital (Outlay reserve, future debt, pay as you go, lbank coverage requirement)	\$	<b>700,000</b>
Operating	\$	<b>1,442,000</b>
Admin Overhead	\$	<b>484,100</b>
	<b>TOTAL</b>	<b>\$ 2,626,100</b>
	<b>TOTAL</b>	<b>\$ 2,993,100</b>
Require Inputs		

<b>REVENUE VS. EXPENSES</b>	<b>\$ (3,305)</b>
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**YEAR 3 - FY 19/20**

<b>REVENUE</b>		<b>CALCULATOR</b>			
<b>Water Sales</b>	<b>Totals</b>		<b>Percentage</b>	<b>Rates</b>	<b>Est. Revenue</b>
Tier 1	74,168		40.7%	\$ 7.00	\$519,176
Tier 2	47,611		26.1%	\$ 8.75	\$416,596
Tier 3	35,151		19.3%	\$ 10.50	\$369,086
Tier 4	25,513		14.0%	\$ 12.25	\$312,534
<b>Total</b>	<b>182,443</b>				<b>\$1,617,392</b>
<b>Base Fee</b>				<b>\$ 76.00</b>	<b>\$1,254,000</b>
<b>Total</b>					<b>\$2,871,392</b>
<b>Other Revenue</b>				<b># Accounts</b>	
Base Fee w/ no consumption				<b>506</b>	\$38,456
Property Tax					\$ 113,741
Water Service Charges					\$47,000
Recycled Water Revenue					\$ 127,085
Other					\$60,000
<b>Total</b>					<b>\$386,282</b>
<b>Require Inputs</b>			<b>TOTAL</b>		<b>\$3,257,674</b>
<b>Recycled Water Revenue Calculator</b>					
		<b>CCF</b>	<b>Revenue</b>		
Tier 1		60	\$ 378		
Tier 2		60	\$ 473		
Tier 3		120	\$ 1,134		
Tier 4		11,347	\$ 125,101		
<b>Total</b>		<b>11,587</b>	<b>\$ 127,085</b>		
				<b>School Irrigation</b>	
				8,563	Commercial ccf
				3,024	Irrigation ccf
				<b>11,587</b>	<b>Total/yr.</b>
<b>EXPENSES</b>		<b>CALCULATOR</b>			
<b>RESERVES</b>					
	Capital Outlay		see below		
	Rate Stabilization		\$ 32,000		
	General Contingency		\$ 57,000		
	Designation for Basin Mgt.		In O&M budget		
	Designation for Water Cons.		\$ -		
<b>Restricted</b>	I-Bank Loan		\$ 278,000		
	<b>TOTAL</b>		<b>\$ 367,000</b>		
<b>GENERAL</b>					
	Capital (Outlay reserve, future debt, pay as you go, Ibank coverage requirement)		\$ 900,000		
	Operating		\$ 1,485,260		
	Admin Overhead		\$ 498,623		
	<b>TOTAL</b>		<b>\$ 2,883,883</b>		
	<b>TOTAL</b>		<b>\$ 3,250,883</b>		
<b>Require Inputs</b>					
<b>REVENUE VS. EXPENSES</b>			<b>\$ 6,791</b>		

**RESOLUTION NO. 2017-11**

**A RESOLUTION OF THE BOARD OF DIRECTORS  
OF THE LOS OSOS COMMUNITY SERVICES DISTRICT  
APPROVING AMENDMENTS TO THE DISTRICT RESERVE POLICY**

**WHEREAS**, the Los Osos Community Services District adopted Resolution 2016-14 establishing a District Reserves Policy and establishing reserve account balances by fund; and

**WHEREAS**, the District desires to revise said Reserve Policy in regards to the Contingency Reserve and the Rate Stabilization reserve as follows:

A General Water Contingency Reserve shall be established for Emergency Operations should a natural or other disaster occur that would temporarily interrupt the District's income from Utility bills, to repair District facilities, and to provide funding for unforeseen circumstances not covered by the District's Operation and Maintenance Budget. The funding goal of this reserve account is an annual appropriation of at least \$57,000 per year up to a maximum cumulative goal of sixty (60%) percent of the District's annual Operation and Maintenance Budget as approved by the Board from time to time.

A Rate Stabilization Reserve shall be established to: Equalize revenues should District income from the Utility billings decrease due to conservation efforts initiated by the District or by the public; and Provide a funding source to offset operation and maintenance revenues associated with fee waivers or reductions approved by the District Board of Directors in accordance with District policies and procedures established pursuant to Government Code Section 61123).(d). Reserves in this category shall be funded by water sales revenues.

The funding goal of this Rate Stabilization Reserve shall be \$32,000 annually until such time as this Rate Stabilization Reserve reaches a total of ten (10%) percent of the total annual water Operation and Maintenance Budget as approved by the Board of Directors from time to time; and once said total is met, the \$32,000 annual allocation shall be allocated annually to the General Water Contingency Reserve, and;

**WHEREAS**, revisions to the current District Reserve Policy are attached hereto.

**NOW, THEREFORE, BE IT RESOLVED** that the Los Osos Community Services District Board of Directors does hereby approve amendments to the District Reserve Policy and fully restates the Reserve Policy attached hereto as Exhibit A.

On the motion of Director \_\_\_\_\_, seconded by Director \_\_\_\_\_,  
and on the following roll call vote, to wit:

Ayes: \_\_\_\_\_  
Nays: \_\_\_\_\_  
Absent: \_\_\_\_\_  
Conflicts: \_\_\_\_\_

The foregoing resolution is hereby passed, approved, and adopted by the Board of Directors of the Los Osos Community Services District this 6<sup>th</sup> day of April 2017.

\_\_\_\_\_  
Jon-Erik Storm  
President, Board of Directors  
Los Osos Community Services District



ATTEST:

APPROVED AS TO FORM:

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Ann Kudart  
Deputy Secretary to the Board

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Roy A. Hanley  
District Legal Counsel