



Oceano Community Services District

1655 Front Street, P.O. Box 599, Oceano, CA 93475

(805) 481-6730 FAX (805) 481-6836

Date: July 8, 2020

To: Board of Directors

From: Will Clemens, General Manager

Subject: Agenda Item #8A: Consideration of policy direction to staff on possible rate modifications and/or increases in accordance with Proposition 218 (Prop 218)

Recommendation

It is recommended that the Board review the staff report and staff presentation and provide direction to staff in developing a modified rate structure for future adoption in accordance with Proposition 218.

Discussion

The District's current water system revenues are insufficient to fund operations and maintenance, capital improvements, and minimum reserve levels. FY 20/21 budgeted revenues are nearly \$485,000 short in covering water system expenditures. If no rate increase process is performed, the drought rates in place will sunset in October 2020 and the Water Fund will run out of money this fiscal year. If a rate increase process is done and the current water rates are maintained, it is projected that the Water Fund would run out of money in FY 2021/22. Therefore, it is necessary to increase water rates at this time to cover necessary water system expenditures.

In October 2017 drought rates were partially reduced and the drought rates will sunset in October 2020. This will severely impact revenues if not addressed. The last non-inflationary rate increase process was done in 2015 to address revenue impacts from the drought and prior to that, rates were increased in 2011. As can be expected, increased water conservation continues, even after the drought ended, which also continues to impact system revenues. Water usage has not significantly increased after the drought ended as shown in the following table:

Total Water Use in Acre Feet

| <u>Year</u> | <u>2011</u> | <u>2012</u> | <u>2013</u> | <u>2014</u> | <u>2015</u> | <u>2016</u> | <u>2017</u> | <u>2018</u> | <u>2019</u> |
|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| | 852 | 838 | 888 | 807 | 703 | 672 | 718 | 725 | 680 |

The successful water conservation efforts on the part of the community has resulted in system revenues falling short in total by \$368,000 since the 2015 rate increase was implemented.



Expenditures

The 2015 rate increase was intended only to address revenue shortfalls related to the drought and certain operation and maintenance expenses. Documentation presented at that time indicated that the rate increase would not address other critical issues such as the Capital Improvement Program (CIP), staffing needs, and reserve policies.

In 2010, Tuckfield and Associates identified an annual expenditure need of \$186,000 for Capital and Long-term maintenance based on the Master Water Plan CIP. That funding need was deferred and never implemented. Since 2014, the District has spent almost \$800,000 on Capital projects. Grants have paid for \$127,000 of that amount and the rest has come from reserves. This has resulted in reserve balances dropping to near the minimum reserve levels needed to operate.

In 2019, grant funding was used to prepare an update to the CIP. That update identified over \$4 million of improvements needed over the next ten years. These improvements should not be deferred any longer. Staff has included an annual expenditure target of \$150,000 to fund the CIP and is phased in over three fiscal years. This amount should be enough to complete the entire CIP with a combination of grant funded, pay-go and debt financed projects. Interest rates are at historic lows and should provide excellent funding terms as can be seen by comparing to the \$186,000 Capital estimate by Tuckfield in 2010.

Additionally, appropriate staffing needs were not included in the 2015 rate increase. Since 2015 there has been one additional utility system worker added to the field crew and one half time account administrator added to the office staff. The District has a total of 4 field staff and 4.5 office staff. The staffing costs are spread among several activities which include the Administration, Fire, Lighting, Facilities, Garbage, Water, and Wastewater funds. In 2018, the Board adopted a change in the allocation of administrative and indirect field crew costs among the various funds to be based on the actual labor costs charged by the field crews to each fund. This change resulted in a shift of costs from the Wastewater Fund to the Water Fund to more accurately reflect the cost of providing these services. The combination of these staffing and allocation changes has resulted in approximately \$280,000 in additional annual costs to the Water Fund since the 2015 rate increase.

The 2015 rate increase did not include any set aside for establishing reserves. Reserves can be established for many purposes including minimum/operating, emergency, capital, debt, contingencies, or rate stabilization reserves. Each type of reserve requires higher rates to establish reserve balances. Staff is not recommending increasing rates to establish any particular reserves other than setting rates so that minimum reserve balances never drop below three months of cash needs or 25% of annual expenses. While it would be advantageous to establish other reserve balances, this approach will minimize the amount of the rate increase needed currently.



Policy Considerations

Revenues:

- ✓ Should the Revenue Target include \$150,000 annually to fund the CIP?
 - Monthly impact to bills is \$4.22.
- ✓ Should the Revenue Target be implemented with a single increase in Year 1 followed by inflationary increases or should it be phased in over 3 years followed by inflationary increases?

The District’s Rate Structure

The following table illustrates the District’s current rate structure:

| Base Rate | Tier #2 | Tier #3 | Tier #4 | Tier #5 |
|--|------------------------------|------------------------------|------------------------------|------------------------------|
| \$ 53.56 Minimum bi-monthly charge (Up to 6 Units) | 7 to 12 Units | 13 to 18 Units | 19 to 24 Units | Over 24 Units |
| | \$3.64 per Unit | \$4.03 per Unit | \$4.51 per Unit | \$4.74 per Unit |
| \$1.80 per Unit for Lopez | \$1.80 per Unit for Lopez | \$1.80 per Unit for Lopez | \$1.80 per Unit for Lopez | \$1.80 per Unit for Lopez |
| | | | | |
| \$1.80 per Unit total | \$5.44 per Unit total | \$5.83 per Unit total | \$6.31 per Unit total | \$6.54 per Unit total |

Policy Considerations

The current rate structure only includes two customer classes, Residential and Non-Residential. This has been justified due to the fact that this is a small water system with little variation in properties within the customer classes. Many agencies include a Single-family Residence and Multi-family Residence rate in their structures. This distinction recognizes the general difference in cost of service between these two types of properties. Multi-family residences would include apartment complexes and mobile home parks served by a master meter, duplex, triplex, etc. In general, Multi-family residences place less storage, peaking, and maintenance and infrastructure demands on the system compared to Single-family residences due to smaller square footages and occupancies and less outdoor watering demand. The base rate for Multi-family Residential customers could be set at 75% of the Single-family Residential rate to estimate this reduced system demand.



Oceano Community Services District

Board of Directors Meeting

The following table illustrates the options for the Year 1 base rate structure under a three-year phase in:

| Option A | | Option B |
|---------------------------|---------------------------|---------------------------|
| Single Family | Multi Family | Residential |
| \$ 60.53 | \$ 45.39 | \$ 54.94 |
| Minimum bi-monthly charge | Minimum bi-monthly charge | Minimum bi-monthly charge |

At the same time as the 2015 Rate increase was being developed, the Prop 218 court decision regarding tiered water rates in San Juan Capistrano was rendered. While not precluding an agency from having tiered rates, it was made more difficult as any tiers were now required to have a clear nexus to cost of service. This will require reducing or eliminating the number of tiers for the District. Creating tiers that are directly tied to the cost of Lopez and State water supplies is clearly a defensible approach. In addition, the provision of 6 Units of water in the Base Rate will need to be eliminated in order for the District's rate structure to be more defensible under Prop 218.

The following table illustrates the options for the volumetric rate structure:

| Option A | | Option B |
|-----------------|-----------------|-----------------|
| Tier #1 | Tier #2 | Uniform Rate |
| 0 to 6 Units | Over 6 Units | All Units |
| \$3.30 per Unit | \$6.47 per Unit | \$5.07 per Unit |

Policy considerations include the following:

- ✓ Should the 6 Units of water in the base rate be eliminated?
 - The need to conform to Prop 218 cost of service supports this approach.
- ✓ Should a new Residential customer class for Multi-family be created?
 - The need to conform to Prop 218 cost of service supports this approach.
- ✓ Should the volumetric rate be uniform, or a two-tiered rate based on cost of Lopez and State water?
 - Either approach can be supported, but a two-tiered rate further encourages water conservation

Other Agency Involvement

The District has water supply contracts with the San Luis Obispo Flood Control and Water Conservation District which provides water supply to Oceano from Lopez Reservoir and the State Water Project.



Oceano Community Services District

Board of Directors Meeting

Other Financial Considerations

Pro Forma projections are attached showing three scenarios. 1) Current rate structure, 2) A single rate increase in Year 1, and 3) A three-year phase in rate increase approach. Options will be presented to your Board during the Staff presentation. Based on direction received, staff will then complete the Revenue Requirements and Rate Study for the District and prepare the rate ordinance for introduction. It is anticipated that the rate ordinance will be introduced, the Proposition 218 notice approved, and other associated documentation presented at the first meeting in August. This will initiate the legally required Proposition 218 process with a Protest Hearing set in October. Any rate increase would become effective with the billing period which begins in November.

Results

Considering the necessary revenues and rate structure to operate the water system is important to promote a safe, healthy, and well-governed District.

Attachment: Pro Forma Projections

Pro Forma - Current Rates

| | | | | | | | |
|------------------------------|----------------------|----------------|-----------|-----------|-----------|-----------|-----------|
| Oceano CSD | Rate Increase | Supply | 3% | 3% | 3% | 3% | 3% |
| | | Base | 3% | 3% | 3% | 3% | 3% |
| Revenues and Expenses | | Cost Inflation | 3% | 3% | 3% | 3% | 3% |

| Total Water Sales (CCF) | 286,637 | 298,522 | 298,522 | 298,522 | 298,522 | 298,522 | 298,522 |
|---|------------------|------------------|------------------|------------------|------------------|------------------|------------------|
| | 2018-19 | 2019-20 | 2020-21 | 2021- 22 | 2022-23 | 2023-24 | 2024-25 |
| | Actual | Estimated | Budget | Projection | Projection | Projection | Projection |
| Water Sales - Supply | 1,155,432 | 1,269,794 | 1,280,760 | 1,319,183 | 1,358,758 | 1,399,521 | 1,441,507 |
| Water Sales - Base | 984,006 | 1,022,206 | 1,049,240 | 1,080,717 | 1,113,139 | 1,146,533 | 1,180,929 |
| System Connection Fees | 45,493 | 50,884 | 51,639 | 53,188 | 54,784 | 56,427 | 58,120 |
| Delinquent Fees | 28,481 | 27,930 | 27,000 | 27,810 | 28,644 | 29,504 | 30,389 |
| New Account Setup Fees | 2,700 | 3,240 | 3,240 | 3,337 | 3,437 | 3,540 | 3,647 |
| Courtesy Notices Fees | 4,322 | 4,329 | 4,500 | 4,635 | 4,774 | 4,917 | 5,065 |
| Wheeling Fees | 22,621 | 21,525 | 25,000 | 25,750 | 26,523 | 27,318 | 28,138 |
| Interest | 2,370 | 0 | 0 | 0 | 0 | 0 | 0 |
| Grant Revenue | 104,318 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other Revenues | 19,978 | 29,330 | 11,350 | 11,691 | 12,041 | 12,402 | 12,775 |
| Total - Revenues | 2,369,720 | 2,429,238 | 2,452,729 | 2,526,311 | 2,602,100 | 2,680,163 | 2,760,568 |
| Water Supply - Lopez (Pass through) | 472,914 | 462,693 | 493,997 | 493,997 | 493,997 | 493,997 | 493,997 |
| Water Supply - State (Pass through) | 953,953 | 1,101,264 | 1,151,000 | 1,151,000 | 1,151,000 | 1,151,000 | 1,151,000 |
| Source of Supply- Expenses | 1,426,867 | 1,563,957 | 1,644,997 | 1,644,997 | 1,644,997 | 1,644,997 | 1,644,997 |
| Salaries & Benefits | 238,932 | 267,692 | 349,858 | 360,354 | 371,164 | 382,299 | 393,768 |
| Admin Allocation | 378,606 | 517,907 | 555,363 | 572,024 | 589,185 | 606,860 | 625,066 |
| Services & Supplies | 223,649 | 203,911 | 291,220 | 299,957 | 308,955 | 318,224 | 327,771 |
| Transfers | 71,375 | 34,888 | 56,075 | 57,757 | 59,490 | 61,275 | 63,113 |
| O&M- Expenses | 912,562 | 1,024,398 | 1,252,516 | 1,290,091 | 1,328,794 | 1,368,658 | 1,409,718 |
| CIP Projects - Fixed Assets | 267,821 | 270,057 | 40,000 | 75,000 | 150,000 | 150,000 | 150,000 |
| Capital - Expenses | 267,821 | 270,057 | 40,000 | 75,000 | 150,000 | 150,000 | 150,000 |
| Total - Expenses | 2,607,250 | 2,858,412 | 2,937,513 | 3,010,088 | 3,123,791 | 3,163,655 | 3,204,715 |
| Revenues minus Expenses | (237,530) | (429,174) | (484,784) | (483,778) | (521,691) | (483,492) | (444,147) |
| Water Fund Ending Reserve Balance | 1,390,488 | 961,314 | 476,530 | (7,248) | (528,939) | (1,012,430) | (1,456,577) |
| Minimum Reserve Balance (3 months expenses) | 651,812 | 714,603 | 734,378 | 752,522 | 780,948 | 790,914 | 801,179 |

Pro Forma - Single Increase

| Oceano CSD | Rate Increase | Supply | 30% | Actual | Actual | Actual | Actual |
|---|------------------|------------------|------------------|------------------|------------------|------------------|------------------|
| Revenues and Expenses | | Base | 24% | 3% | 3% | 3% | 3% |
| | | Cost Inflation | 3% | 3% | 3% | 3% | 3% |
| Total Water Sales (CCF) | 286,637 | 298,522 | 298,522 | 298,522 | 298,522 | 298,522 | 298,522 |
| | 2018-19 | 2019-20 | 2020-21 | 2021- 22 | 2022-23 | 2023-24 | 2024-25 |
| | Actual | Estimated | Budget | Projection | Projection | Projection | Projection |
| Water Sales - Supply | 1,155,432 | 1,269,794 | 1,650,732 | 1,644,997 | 1,644,997 | 1,644,997 | 1,644,997 |
| Water Sales - Base | 984,006 | 1,022,206 | 1,267,536 | 1,305,562 | 1,344,729 | 1,385,070 | 1,426,623 |
| System Connection Fees | 45,493 | 50,884 | 51,639 | 53,188 | 54,784 | 56,427 | 58,120 |
| Delinquent Fees | 28,481 | 27,930 | 27,000 | 27,810 | 28,644 | 29,504 | 30,389 |
| New Account Setup Fees | 2,700 | 3,240 | 3,240 | 3,337 | 3,437 | 3,540 | 3,647 |
| Courtesy Notices Fees | 4,322 | 4,329 | 4,500 | 4,635 | 4,774 | 4,917 | 5,065 |
| Wheeling Fees | 22,621 | 21,525 | 25,000 | 25,750 | 26,523 | 27,318 | 28,138 |
| Interest | 2,370 | 0 | 0 | 0 | 0 | 0 | 0 |
| Grant Revenue | 104,318 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other Revenues | 19,978 | 29,330 | 11,350 | 11,691 | 12,041 | 12,402 | 12,775 |
| Total - Revenues | 2,369,720 | 2,429,238 | 3,040,997 | 3,076,970 | 3,119,929 | 3,164,177 | 3,209,752 |
| Water Supply - Lopez (Pass through) | 472,914 | 462,693 | 493,997 | 493,997 | 493,997 | 493,997 | 493,997 |
| Water Supply - State (Pass through) | 953,953 | 1,101,264 | 1,151,000 | 1,151,000 | 1,151,000 | 1,151,000 | 1,151,000 |
| Source of Supply- Expenses | 1,426,867 | 1,563,957 | 1,644,997 | 1,644,997 | 1,644,997 | 1,644,997 | 1,644,997 |
| Salaries & Benefits | 238,932 | 267,692 | 349,858 | 360,354 | 371,164 | 382,299 | 393,768 |
| Admin Allocation | 378,606 | 517,907 | 555,363 | 572,024 | 589,185 | 606,860 | 625,066 |
| Services & Supplies | 223,649 | 203,911 | 291,220 | 299,957 | 308,955 | 318,224 | 327,771 |
| Transfers | 71,375 | 34,888 | 56,075 | 57,757 | 59,490 | 61,275 | 63,113 |
| O&M- Expenses | 912,562 | 1,024,398 | 1,252,516 | 1,290,091 | 1,328,794 | 1,368,658 | 1,409,718 |
| CIP Projects - Fixed Assets | 267,821 | 270,057 | 40,000 | 75,000 | 150,000 | 150,000 | 150,000 |
| Capital - Expenses | 267,821 | 270,057 | 40,000 | 75,000 | 150,000 | 150,000 | 150,000 |
| Total - Expenses | 2,607,250 | 2,858,412 | 2,937,513 | 3,010,088 | 3,123,791 | 3,163,655 | 3,204,715 |
| Revenues minus Expenses | (237,530) | (429,174) | 103,484 | 66,881 | (3,862) | 522 | 5,037 |
| Water Fund Ending Reserve Balance | 1,390,488 | 961,314 | 1,064,798 | 1,131,679 | 1,127,816 | 1,128,338 | 1,133,375 |
| Minimum Reserve Balance (3 months expenses) | 651,812 | 714,603 | 734,378 | 752,522 | 780,948 | 790,914 | 801,179 |

Pro Forma - Phased Increase

| Oceano CSD | Rate Increase | Supply | 13% | Actual | Actual | Actual | Actual |
|---|------------------|------------------|------------------|------------------|------------------|------------------|------------------|
| Revenues and Expenses | | Base | 13% | 10% | 10% | 3% | 3% |
| | | Cost Inflation | 3% | 3% | 3% | 3% | 3% |
| Total Water Sales (CCF) | 286,637 | 298,522 | 298,522 | 298,522 | 298,522 | 298,522 | 298,522 |
| | 2018-19 | 2019-20 | 2020-21 | 2021- 22 | 2022-23 | 2023-24 | 2024-25 |
| | Actual | Estimated | Budget | Projection | Projection | Projection | Projection |
| Water Sales - Supply | 1,155,432 | 1,269,794 | 1,434,867 | 1,644,997 | 1,644,997 | 1,644,997 | 1,644,997 |
| Water Sales - Base | 984,006 | 1,022,206 | 1,155,093 | 1,270,602 | 1,397,663 | 1,439,592 | 1,482,780 |
| System Connection Fees | 45,493 | 50,884 | 51,639 | 52,000 | 52,000 | 52,000 | 52,000 |
| Delinquent Fees | 28,481 | 27,930 | 27,000 | 27,000 | 27,000 | 27,000 | 27,000 |
| New Account Setup Fees | 2,700 | 3,240 | 3,240 | 3,240 | 3,240 | 3,240 | 3,240 |
| Courtesy Notices Fees | 4,322 | 4,329 | 4,500 | 4,500 | 4,500 | 4,500 | 4,500 |
| Wheeling Fees | 22,621 | 21,525 | 25,000 | 25,000 | 25,000 | 25,000 | 25,000 |
| Interest | 2,370 | 0 | 0 | 0 | 0 | 0 | 0 |
| Grant Revenue | 104,318 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other Revenues | 19,978 | 29,330 | 11,350 | 11,350 | 11,350 | 11,350 | 11,350 |
| Total - Revenues | 2,369,720 | 2,429,238 | 2,712,689 | 3,038,689 | 3,165,750 | 3,207,679 | 3,250,867 |
| Water Supply - Lopez (Pass through) | 472,914 | 462,693 | 493,997 | 493,997 | 493,997 | 493,997 | 493,997 |
| Water Supply - State (Pass through) | 953,953 | 1,101,264 | 1,151,000 | 1,151,000 | 1,151,000 | 1,151,000 | 1,151,000 |
| Source of Supply- Expenses | 1,426,867 | 1,563,957 | 1,644,997 | 1,644,997 | 1,644,997 | 1,644,997 | 1,644,997 |
| Salaries & Benefits | 238,932 | 267,692 | 349,858 | 360,354 | 371,164 | 382,299 | 393,768 |
| Admin Allocation | 378,606 | 517,907 | 555,363 | 572,024 | 589,185 | 606,860 | 625,066 |
| Services & Supplies | 223,649 | 203,911 | 291,220 | 299,957 | 308,955 | 318,224 | 327,771 |
| Transfers | 71,375 | 34,888 | 56,075 | 57,757 | 59,490 | 61,275 | 63,113 |
| O&M- Expenses | 912,562 | 1,024,398 | 1,252,516 | 1,290,091 | 1,328,794 | 1,368,658 | 1,409,718 |
| CIP Projects - Fixed Assets | 267,821 | 270,057 | 40,000 | 75,000 | 150,000 | 150,000 | 150,000 |
| Capital - Expenses | 267,821 | 270,057 | 40,000 | 75,000 | 150,000 | 150,000 | 150,000 |
| Total - Expenses | 2,607,250 | 2,858,412 | 2,937,513 | 3,010,088 | 3,123,791 | 3,163,655 | 3,204,715 |
| Revenues minus Expenses | (237,530) | (429,174) | (224,824) | 28,601 | 41,958 | 44,024 | 46,152 |
| Water Fund Ending Reserve Balance | 1,390,488 | 961,314 | 736,490 | 765,091 | 807,049 | 851,074 | 897,226 |
| Minimum Reserve Balance (3 months expenses) | 651,812 | 714,603 | 734,378 | 752,522 | 780,948 | 790,914 | 801,179 |