

INFORMATION REGARDING PROPOSED WATER RATE ADJUSTMENTS

On December 16, 2009, District staff presented a draft update to the District's Water Rate Study. The Board directed staff to schedule a public hearing in compliance with Proposition 218 requirements to consider adoption of the recommendations made in the updated Water Rate Study. The public hearing is scheduled for February 24, 2010 at 6:00 p.m. in the Encinitas Council Chambers.

Attached is the staff report for the December 16 meeting and the Water Rate Study prepared by Raftelis Financial Consultants, Inc.

If you have any questions regarding the proposed rate adjustments, please call the District office at (760) 633-2709.



**SAN DIEGUITO WATER
DISTRICT
AGENDA REPORT
Meeting Date: December 16, 2009**

TO: Board Members

VIA: Phil Cotton, District Secretary
Lawrence A. Watt, General Manager
Jennifer Smith, Director of Finance

FROM: Bill O'Donnell, Senior Engineer

SUBJECT: Presentation of Draft Results of Update to the San Dieguito Water District's Water Rate Study Prepared by Raftelis Financial Consultants, Inc.

BACKGROUND: On July 18, 2007, the District Board approved the selection of Raftelis Financial Consultants, Inc. (RFC) to complete a Water Rate Study ("Study") for Fiscal Years 07/08 through 09/10. The study recommended an overall 5.5% increase in revenues for each of the three fiscal years. On February 27, 2008, the Board adopted Resolution No. 2008-05 which approved the recommended adjustments. Two of the three increases have been implemented. The final increase is set to become effective on January 1, 2010.

The Study assumed that the cost of imported water would increase between 7 to 10% each year. These numbers were in line with projections that RFC received from the San Diego County Water Authority (CWA). Last year, imported water costs increased 17%. Since the District received more local water than anticipated, the increase in imported water costs did not severely impact the overall budget. Due mainly to lower water sales and a loss of reliable water supplies this year, imported water costs increased 15% and were implemented four months early which equates to a 20% rate increase. Next year, CWA is projecting a 17.8% rate increase.

Also, R.E. Badger Filtration Plant (owned jointly with Santa Fe Irrigation District) has recently completed a 10-year Capital Improvement Study. The Study anticipates the need to begin construction on some large scale projects within the next two years. These projects include improving the Plant's disinfection system and replacing the San Dieguito Reservoir pump station. The cost of these new projects was not included in the original rate study.

Finally, the District's interest earnings have significantly decreased due to a substantial reduction in interest rates. Interest earnings have fallen over \$600,000 from earnings received as recently as Fiscal Year 05/06.

The increases to both the imported water rate and Badger's CIP budget, along with the decrease in interest earnings, will require an adjustment to District revenues considerably higher than the 5.5% increase previously adopted.

On May 27, 2009, the District Board authorized staff to enter into a contract with RFC to provide a two-year update to the District's 2007 Water Rate Study and appointed Board members Bond and Barth to a water rate subcommittee. The two-year update will add one additional year to the study. The update will then align with the District's two-year budget cycle.

ANALYSIS: RFC developed alternative revenue scenarios for the water rate subcommittee to review. An alternative that employs a combination of rate and meter charge increases and the utilization of reserves was chosen by the subcommittee as the preferred alternative. Under this plan, detailed in the attached Draft Water Rate Study, the District's reserves would be drawn down approximately \$2.4 million over the next two years. The draw down in reserves helps mitigate the impact of wholesale water rate increases, while still leaving the reserves close to target levels. In addition, there would be an increase in water rates and meter service charges that would result in a revenue increase of up to 13% each of the next two years. Rate impacts would vary between rate classes based on the cost of service to provide water to each class.

RFC also proposed an update to the District's drought rates. Drought rates are imposed when a mandatory cutback in water use is required. The previous drought rate schedule presented rates for cutback levels at 10% increments, which was consistent with CWA drought policies at the time. CWA has since revised the drought policy to allow more flexibility for proposed cutbacks. Currently, CWA is requiring an 8% cutback. Since the District's lowest drought rate was at a 10% cutback, the District was not able to implement drought rates, which resulted in a decrease in revenues. The proposed drought rates will include rates in blocks of 10%, but will also allow the District to prorate any cutbacks that fall between the 10% increments.

Under the proposed rate system with the current drought requirement of an 8% cutback, the District's average customer (bi-monthly usage of 30 hundred cubic feet of water with a ¾" meter) will see a 19.9% increase in their bill if they do not cut back their water usage. An average customer that does meet the 8% cutback will see a 12.3% increase in their bill. In comparison with 13 other local water agencies, the District's average customer's bill will be the fourth lowest (see Figure 5-1 in the Draft Rate Study, page 27).

During the last rate study, certain reserve level targets were adopted. The capital replacement reserve level was set at 10% of the system replacement cost (\$7 million). After comparing the District's capital reserve level policy with other agencies, it is recommended that a more appropriate target would be to have a minimum balance equal to an average of two fiscal years of approved capital expenditures and a maximum balance equal to an average of three fiscal years of approved capital expenditures. Under this concept, the District capital reserve level would then be tied directly to the capital replacement budget. Based on Board discussion, if the Board is amenable to this concept, a policy formalizing this method of dealing with the capital reserve fund will be brought back for Board consideration at a future date.

As mentioned previously, there are several large scale projects that will be constructed at the R.E. Badger Filtration Plant in the next two years. It may be beneficial to fund these projects through debt issuance since interest rates are low. Staff is currently in the process of analyzing the costs and benefits associated with debt issuance. If it seems beneficial to issue debt to fund these projects, staff will bring this to the Board for consideration.

FISCAL AND STAFF IMPACTS: The recommended rate and charge structure, along with a draw down of the District's reserves, will allow the District to continue to remain in a balanced financial position. It should be noted though that overall reserve levels will be drawn down below existing target levels. Given the current state of the economy, it seems prudent to utilize a portion of the reserves to reduce rate increases to the ratepayers. Once the economy and imported water rates stabilize, reserve levels may be brought back up to target levels or the target levels may be adjusted.

Setting the capital reserve target to a minimum balance of an average of two years of approved capital expenditures and a maximum of three years of approved capital expenditures would reduce the target level from \$7 million to a minimum of \$4.1 million and a maximum of \$5.9 million.

RECOMMENDATION: 1. Receive the draft report of San Dieguito Water District's Water Rate Study, review and discuss the information presented, and advise staff of changes, if any, desired by the Board.

2. If no changes are desired, direct staff to schedule a public hearing in compliance with Proposition 218 requirements to consider adoption of the recommendations made in the Water Rate Study.

San Dieguito Water District

WATER RATE STUDY



January 2010

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I. EXECUTIVE SUMMARY

The San Dieguito Water District (District) wished to conduct a comprehensive water rate study that included a review of revenue requirements, user classifications, costs of services, the design of a system of user charges for the District's water service that would promote water conservation, and adjustments to those user charges that could be implemented for the ongoing drought. The District engaged Raftelis Financial Consultants, Inc. (RFC) to update its rate and financial planning model (Rate Model) that will be used to evaluate alternative rate structures and to provide more detailed forecasts to assist in planning and updating rates in future years. This report documents the results of the study and suggests changes to cost allocations and the water rate structures that will serve to better meet the District's pricing objectives during Fiscal Year 2010-2011 and beyond.

The specific objectives of this study include the development of a rate structure that:

- is consistent with the cost of providing service;
- establishes adequate reserve levels;
- provides adequate debt service coverage;
- promotes conservation;
- provides financial sufficiency to meet the expenses of the enterprise; and
- provides revenue stability.

A. REVIEW FINDINGS

REVIEW OF REVENUE REQUIREMENTS

The District's principal source of operating revenue is revenue from rates. The major source of capital revenue is capacity fees and interest earnings.

Estimates show the District's total revenue requirements for fiscal year (FY) 2010 to be approximately \$11.2 million. The Capital Improvement Program (CIP) will be financed through rate revenue, capacity fees and capital replacement reserves. Favorable market conditions and the District's capacity to service debt suggest that the District should explore funding at least some of the future capital projects via debt. However, as it is uncertain if that will occur, this study assumes all capital projects are non-debt funded. In order to sustain operations, adequately fund reserves, and meet debt coverage requirements, the District will need to increase revenues by 13% for two fiscal years beginning in FY10.

There are three main issues driving the need to increase revenues:

- Imported water costs. These costs comprise over one third of the District's operating expenses and are scheduled to increase 15.1% this year and 17.8% next year. While the District aims to mitigate the impact of these large rate increases on its customers by utilizing its rate stabilization reserve, the reserve cannot absorb the entirety of these cost increases.
- Increased capital costs. Recently the average annual capital expenditure has increased from approximately \$1 million to \$2 million. These costs are largely due to needed improvements at the Badger Treatment Plant.
- Decrease in interest earnings. Interest earnings have decreased over \$600,000 since FY06 due to market conditions.

COST OF SERVICE (COS)

The total FY10 cost of service to be recovered from the District's potable retail users through rates is estimated at approximately \$11.2 million. The cost of service allocations conducted in this study are based on the Base-Extra Capacity method endorsed by the American Water Works Association (AWWA), a nationally recognized industry group. Under the Base-Extra Capacity method, revenue requirements are allocated to the different user classes proportionately to their use of the water system. Allocations are based on average day (base), maximum day peak (Max Day) usage, maximum hour peak (Max Hour) usage, meters and services, and billing and customer service.

RATE DESIGN

The rate alternative presented in this study incorporates AWWA recommended methodologies adapted to meet the District's specific characteristics and provide for a system of user charges that will enhance the proportionate recovery of costs from the various user classes.

RESERVES

The District reserves consist of the following: an operating fund, a capital replacement fund, and a rate stabilization reserve. (The District also has a recycled water fund and debt service fund, but they are not used to hold reserves.) Because the District will draw down reserves to mitigate some of the significant operating and capital cost increases, the reserves will be below target for a few years. They will be built up back to target levels

gradually to minimize potential impacts on customers and enhance the financial stability of the District.

We recommend the following targets for the District's reserve:

- Operating Reserve – 60 days worth of annual operating expenses
- Rate Stabilization Reserve – 15% of annual rate revenue
- Capital Replacement – between 2 and 3 times average annual capital expenditures (Currently \$4 to \$6 million dollars)

II. INTRODUCTION

The San Dieguito Water District (District) engaged Raftelis Financial Consulting, Inc. (RFC) to perform a water cost of service study. The key deliverables of the study were a financial plan and water rates that would ensure the financial stability of the District during normal and drought conditions and promote conservation. The rates were developed in a financial planning and rate model to be used to evaluate alternative rate structures and to provide more detailed forecasts to assist in future years. The goal of the study was to revise and update the current water rates to ensure revenue requirements are met in a manner that reflect cost of service. Accordingly, RFC developed the Rate Model to assist the District in evaluating various water rate alternatives and the impacts on customers, drought rates and the associated impacts, and reserve funding policies.

A. CURRENT ENVIRONMENT

The District currently serves a population of over 37,000 people, with approximately 11,300 water services. The District purchases the majority of its water from the San Diego County Water Authority (SDCWA) and also has rights to local water stored in Lake Hodges. In fiscal year 2010 (FY10), the District projects to use 3,700 acre feet (AF) of local water from Lake Hodges and 3,700 AF from SDCWA. The District also sells approximately 700 AF of recycled water received from the San Elijo Joint Powers Authority (SEJPA). The District's current conservation objectives are driven by the limited water resources, regional drought conditions, rapidly increasing costs of imported water and the volatility of local water supply.

B. STUDY AND PRICING OBJECTIVES

The primary objective of the study was to develop a financial plan and rates to ensure the financial stability of the District. Rates should be consistent with cost of service principles to ensure fairness and equity amongst customer classes.

C. SCOPE OF THE STUDY

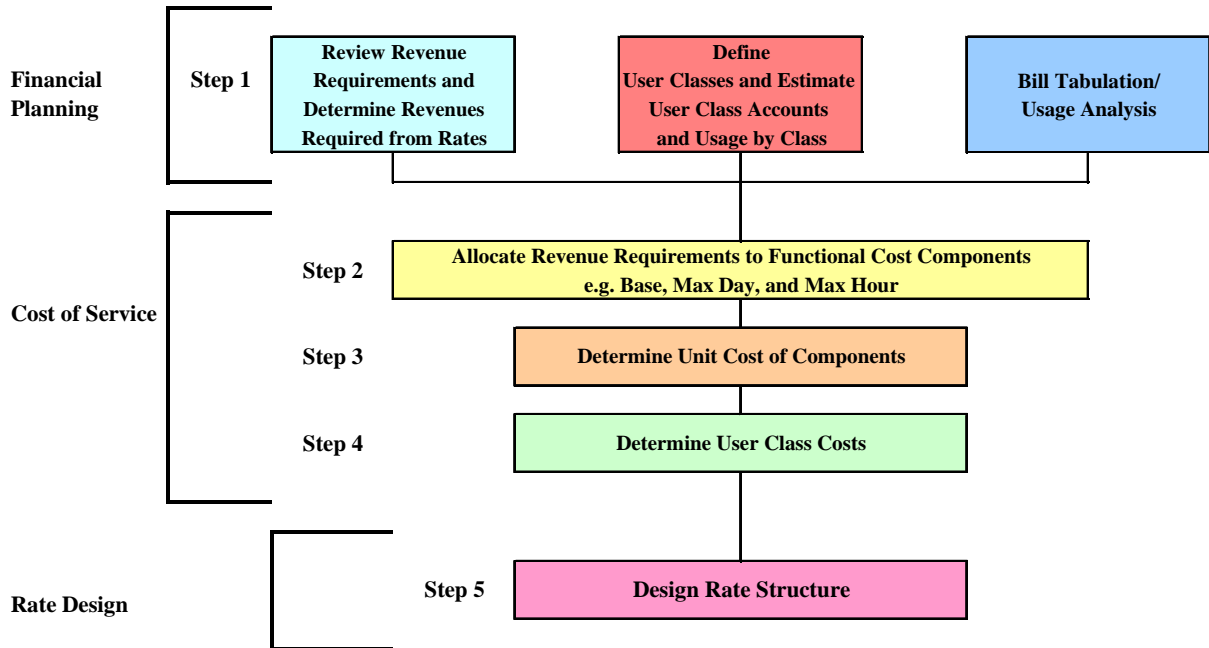
The scope of this study results in the development of cost-based water user rates through a comprehensive cost of service and rate design study process. Figure 2-1 on the following page provides a pictorial representation of the various steps involved in the comprehensive cost of service and rate design process. The steps involved are:

- Financial Planning: Revenue requirements are projected for FY10. Financial planning involves estimation of annual Operating and Maintenance (O&M) and capital

expenditures, reserve targets, operating and capital revenue sources and the determination of required annual user revenues from rates and charges.

- **Cost of Service Analysis:** Cost of service analysis involves identifying and apportioning annual revenue requirements to the different user classes proportionate to their demand on the water system.
- **Rate Design:** Rate design involves the development of a fixed and variable schedule of rates for different user classes to proportionately recover the costs attributable to them. Policy objectives, such as encouraging conservation, are considered at this stage.

**FIGURE 2-1
COST OF SERVICE/RATE DESIGN PROCESS**



III. WATER SYSTEM AND CURRENT WATER RATE STRUCTURE

This section of the report presents a brief overview of the water sources, existing rates, and user/usage characteristics.

A. WATER SOURCES

District customers demand water for a number of purposes, including residential, commercial, and agricultural uses. The District serves its potable customers with local water from Lake Hodges and imported water through SDCWA. The District serves recycled water purchased from SEJPA.

The local water supply in Lake Hodges is not always reliable due to drought and hydrological conditions. During years in which local water is in limited supply, the District must purchase a greater percentage of its potable water supply through SDCWA. Because local water supply is considerably less expensive than imported water—approximately \$142/AF vs. \$603/AF respectively (treatment costs are excluded as both sources must be treated, but pumping posts are included for local water)—the District's water supply costs are subject to large fluctuations from year to year.

B. EXISTING WATER RATE STRUCTURE

The District currently implements a tiered rate structure for residential customers and a uniform water rate structure for non-residential customers. Some agriculture and commercial customers also have residential dwelling units as part of the property, so the first 40 units of usage bi-monthly are billed at the single family residential (SFR) or multi-family residential (MFR) rates and any remaining usage is billed at the agriculture or commercial rate. One billing unit is equal 100 cubic feet (hcf) or 748 gallons. This rate structure also includes a meter service charge that varies with meter size and a billing and customer service charge that is the same for all potable users. Billing is done on a bi-monthly basis. The District last updated its rates with a 5.5% revenue increase in January 2009. Table 3-1 outlines existing rates.

**TABLE 3-1
EXISTING BI-MONTHLY WATER RATE STRUCTURE**

Meter Size	Bi-Monthly Service Charge	Bi-Monthly Fire Charge
5/8" & 3/4"	\$ 27.52	N/A
1"	\$ 44.00	\$ 5.34
1.5"	\$ 85.21	\$ 10.21
2"	\$ 134.67	\$ 18.61
3"	\$ 250.07	\$ 48.74
4"	\$ 423.80	\$ 100.71
6"	\$ 827.04	\$ 287.24
8"	\$ 1,343.74	\$ 608.97

Commodity Rates (hcf)

Customer Class	Existing Block	Existing Rates
SFR	12	\$ 1.79
	20	\$ 2.45
	40	\$ 3.07
	41+	\$ 3.72
SFR w/ Ag.	12	\$ 1.79
	20	\$ 2.45
	40	\$ 3.07
	41+	\$ 2.26
SFR w/ Commercial	12	\$ 1.79
	20	\$ 2.45
	40	\$ 3.07
	41+	\$ 2.49
MFR	8	\$ 1.79
	12	\$ 2.45
	16	\$ 3.07
		\$ 3.72
MFR w/ Ag.	8	\$ 1.79
	12	\$ 2.45
	16	\$ 3.07
	17+	\$ 2.26
MFR w/ Commercial	8	\$ 1.79
	12	\$ 2.45
	16	\$ 3.07
	17+	\$ 2.49
Agriculture		\$ 2.26
Commercial		\$ 2.49
Landscaping		\$ 3.04
Public		\$ 2.49
Government		\$ 2.49
Excess Use		\$ 3.04
Construction		\$ 3.04

C. GROWTH

The District is mostly built out and is only expected to grow at a 0.6% rate in FY10 and each year over the life of this study. Water usage is expected to grow proportionally to the limited number of additional users.

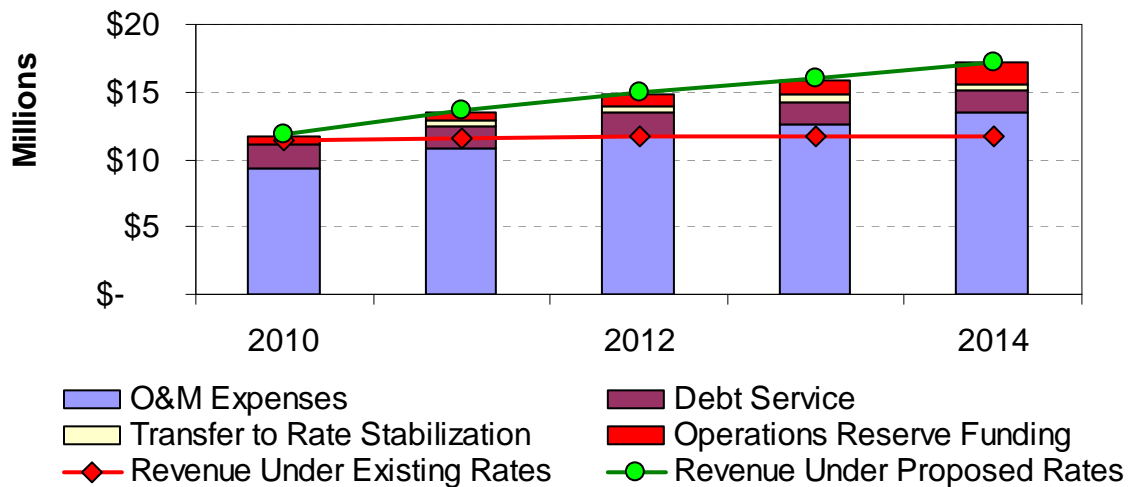
IV. REVENUE REQUIREMENTS

A review of a utility's revenue requirements is a key first step in the rate design process. The review involves an analysis of annual operating revenues under existing rates, O&M expenses, capital expenditures, reserves, and transfers between funds. This section of the report provides a discussion of the projected revenues, operating and capital expenditures, debt coverage requirements, reserve funding policies, and the revenue adjustments required to ensure the financial stability of the water enterprise.

A. PROJECTED REVENUES

The largest expenses in FY10 are the general O&M expenses and water supply costs. Figure 4-1 below displays the District's water revenue and revenue requirements projected by the Rate Model over a five year period.

**FIGURE 4-1
REVENUE REQUIREMENTS**



As you can see from the red line in Figure 4-1, the District's existing rate revenue stream is insufficient to meet current and future revenue requirements. Revenue adjustments will be needed. Without revenue increases, the District will be running a deficit by FY11.

B. OPERATING AND CAPITAL EXPENSES

The District's FY10 water budget was used as the base year in the Rate Model. Various escalation rates were used to project future O&M expenses. Nearly all O&M expenses are subject to an annual 3 percent inflation increase (based on historical CPI), while others have an additional escalation factor related to growth. Notable escalation factors are as follows:

- Imported water purchase costs and other related fixed costs were escalated according to projections done by SDCWA. These increases range from 5% to 17.8% depending on the year.
- Personnel/Labor (including benefits) escalate at 4%.
- Average annual capital expenditure increases from \$1 million to \$2 million.

The District's current detailed Capital Improvement Program (CIP) extends through FY15. The CIP is shown in Table 4-1.

TABLE 4-1
FY 2010-2015 CAPITAL IMPROVEMENTS

<u>Capital Projects</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>
Water Distribution Line Upgrades (CWW10A)	\$ 350,000	\$ 350,000	\$ 350,000	\$ 350,000	\$ 350,000	\$ 350,000
Badger Plant Capital Acquisitions (CWW10B)	\$ 40,000	\$ 40,000	\$ 40,000	\$ 40,000	\$ 40,000	\$ 40,000
Water Valve Replacement (CWW10C)	\$ 250,000	\$ 250,000	\$ 250,000	\$ 250,000	\$ 250,000	\$ 250,000
R.E. Badger CIP (CWW10N)	\$ 550,000	\$ 1,450,000	\$ 975,000	\$ 975,000	\$ 975,000	\$ 975,000
Meter Replacement and Automated Program (CWW10E)	\$ 100,000	\$ 100,000	\$ 100,000	\$ 100,000	\$ 100,000	\$ 100,000
Fire Hydrants Installation (CWW08I)	\$ 75,000	\$ 75,000	\$ -	\$ -	\$ -	\$ -
Transmission Lines Motorized Actuators (CWW01A)	\$ 100,000	\$ 100,000	\$ 100,000	\$ 100,000	\$ -	\$ -
SDWD Rate Study Update (CWW10J)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
R.E. Badger Master Plan (TBD)	\$ -	\$ 124,000	\$ -	\$ -	\$ -	\$ -
SDWD Master Plan Update (CWW09H)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Anode Bed Replacement (CWW10L)	\$ 165,000	\$ -	\$ -	\$ -	\$ -	\$ -
SDWD Drought Allocation Study (CWW10M)	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Water Master Plan	\$ 60,000	\$ -	\$ -	\$ -	\$ -	\$ -
Water Rate Study Update	\$ 75,000	\$ -	\$ -	\$ -	\$ -	\$ -
Drought Allocation Study	\$ 75,000	\$ -	\$ -	\$ -	\$ -	\$ -
HTE Replacement	\$ -	\$ 75,000	\$ -	\$ -	\$ -	\$ -
Total	\$ 1,840,000	\$ 2,564,000	\$ 1,815,000	\$ 1,815,000	\$ 1,715,000	\$ 1,715,000

C. DEBT COVERAGE

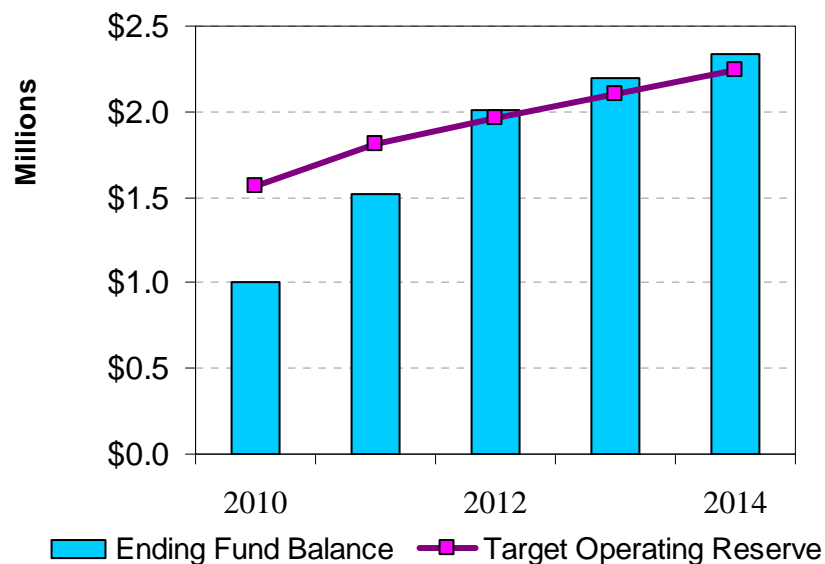
The District must ensure that its revenues are sufficient to meet the Revenue Bond debt coverage requirements of 115% of annual debt service. Failure to meet its coverage ratio could potentially damage the District's credit rating, resulting in higher interest rates when the District returns to the debt market in the future. The District is currently meeting its coverage requirements and under the proposed revenue projections the District will continue to meet coverage during the planning period.

D. RESERVES

The District reserves consist of the following: an operating reserve, a capital replacement reserve, and a rate stabilization reserve. The District's reserves are below targeted levels due to utilization of them during the current drought period. We recommend that in the near term, the District should draw down reserves to reduce proposed rate increases and then build up reserves gradually to minimize potential impacts on customers and enhance the financial stability of the District. Reserve fund cash flows are shown in Figures 4-2 through 4-4.

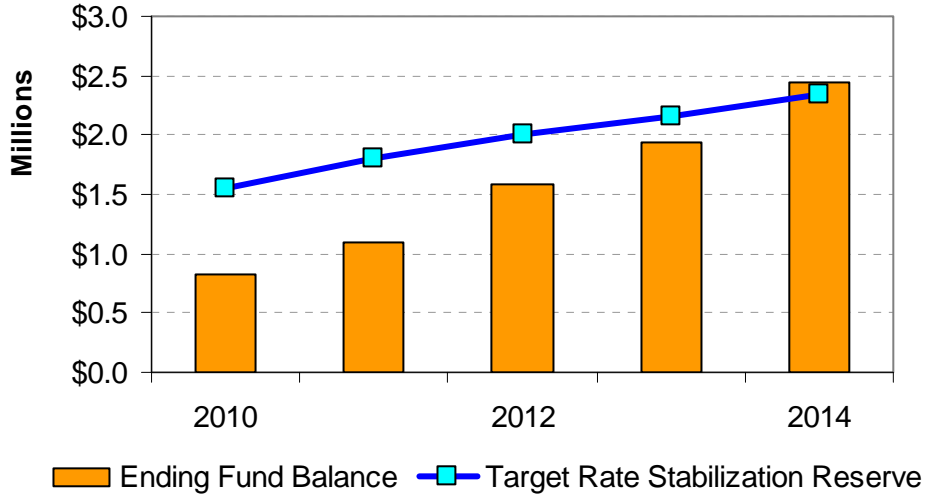
Operating reserves are used for working capital requirements to meet the ongoing expenses of the District. Because the District's fixed rate revenue is 25% of total rate revenue, the District's cash flows are pretty stable and the District's current target of 2 months of annual operating expenses is appropriate. As shown in Figure 4-2, the District is currently below this target, but the reserve will be built up over time and should reach the target by FY12.

**FIGURE 4-2
OPERATING RESERVE**



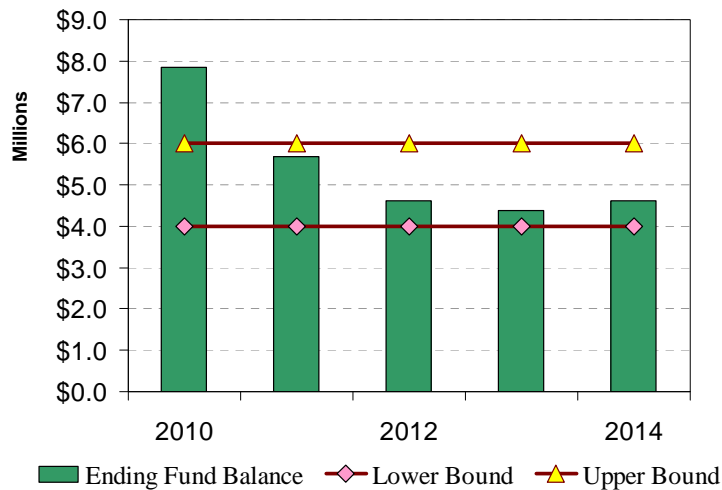
Rate stabilization reserves are used to help offset unexpected or unforeseen costs for purchased water or system repair. True to its purpose, the District has used this reserve to absorb some of the unexpected cost increases due to drought conditions. The reserve will be below target for the next few years, but will be built up over time and at target again by FY14. The Rate Stabilization Reserve is shown in Figure 4-3.

**FIGURE 4-3
RATE STABILIZATION RESERVE**



Capital replacement reserves are used to ensure adequate funding for capital needs. The District’s informal target is approximately 10% of the system replacement cost—presently \$7 million—as determined in a previous capacity fee study. The system replacement cost is adjusted annually by the estimated construction cost escalator (5%). This reserve target is justifiable, although somewhat conservative. We recommend a target range with the lower and upper bounds of two times and three times average annual capital costs. Presently, this is a target between \$4 and \$6 million. The capital reserve and target are shown in Figure 4-4.

**FIGURE 4-4
CAPITAL REPLACEMENT FUND**



**TABLE 4-3
RESERVE FUND CASH FLOW**

Line No.		Budget 2010 \$	Projected 2011 \$
Operations Fund (531)			
<i>Source of Funds</i>			
1	Beginning Balance	1,036,904	1,010,185
2	Net Annual Cash Balance	558,091	602,933
3	Total Funds Available	1,594,995	1,613,117
<i>Use of Funds</i>			
4	Net Annual Cash Balance	-	-
5	Transfer to Rate Stabilization	594,995	113,117
6	Transfer to Capital Reserve		
7	Total Use of Funds	594,995	113,117
8	Ending Fund Balance Before Interest	1,000,000	1,500,000
9	Interest	10,185	18,826
10	Ending Fund Balance	1,010,185	1,518,826
11	Proposed Target Balance	1,564,994	1,809,627
Capital Replacement Fund (534)			
<i>Source of Funds</i>			
13	Beginning Balance	8,142,084	7,847,702
14	Transfer from Operations	-	-
15	Capacity Fees (Buy-in)	40,000	40,000
16	Transfer from Rate Stabilization	1,426,067	250,000
17	Transfer from Construction Fund	-	-
18	Total Funds Available	9,608,151	8,137,702
<i>Use of Funds</i>			
19	Capital Projects - PAYGO	1,840,000	2,564,000
20	Capital Projects - Bond Proceeds	-	-
22	Total Use of Funds	1,840,000	2,564,000
23	Ending Fund Balance Before Interest	7,768,151	5,573,702
24	Interest	79,551	100,661
25	Ending Fund Balance	7,847,702	5,674,362
Rate Stabilization (535)			
<i>Source of Funds</i>			
26	Beginning Balance	1,539,403	820,070
27	Transfer from Operations	100,000	400,000
28	Transfer from Operations Fund (531)	594,995	113,117
29	Total Funds Available	2,234,398	1,333,187
<i>Use of Funds</i>			
30	Transfer to Capital Replacement Reserve	1,426,067	250,000
32	Total Use of Funds	1,426,067	250,000
33	Ending Fund Balance Before Interest	808,331	1,083,187
34	Interest	11,739	14,274
35	Ending Fund Balance	820,070	1,097,461
36	Target Balance	1,558,331	1,807,847

E. PROPOSED REVENUE ADJUSTMENTS

The pro forma operations statement or cash flow summary presented in Table 4-4 provides a basis for evaluating the timing and level of water revenue adjustments required to meet the projected revenue requirements for the study period. In order to meet projected revenue requirements and to maintain desired reserve fund balances, a revenue increase of 13% is recommended for the current and next fiscal year (shown on lines 2 and 3 in Table 4-4). The increase for FY11 is recommended to be effective on January 1.

**TABLE 4-4
CASH FLOW**

Line No.	Revenue	Budget 2010	Projected 2011
1	Revenue from Existing Rates	\$ 9,957,374	\$ 10,014,811
Additional Revenue Required:			
			Months
			Effective
2	FY 2010	13.0%	4
3	FY 2011	13.0%	6
4	Total Revenue from Rates	\$ 10,388,874	\$ 12,052,311
5	Misc. Operating Revenue	\$ 1,418,045	\$ 1,564,623
6	Total Revenue	\$ 11,806,919	\$ 13,616,934
7	Revenue Requirements		
8	O&M Expenses	\$ 9,389,965	\$ 10,857,763
9	Transfer to Debt Service Fund (DSF)	\$ 1,661,363	\$ 1,658,738
10	New Transfer to DSF	\$ -	\$ -
11	City Advances	\$ 85,000	\$ 85,000
12	Administrative	\$ 12,500	\$ 12,500
13	Transfer to Rate Stabilization	\$ 100,000	\$ 400,000
14	Total Revenue Requirements	\$ 11,248,828	\$ 13,014,001
15	Net Annual Cash Balance	\$ 558,091	\$ 602,933

V. PROPOSED RATES & CUSTOMER IMPACTS

The recommended water rates are calculated based on the projected revenue requirements for FY10. As mentioned in the previous section, these revenue requirements are forecasted, with some adjustments, using the FY10 budget as a base year. The Rate Model is designed to accommodate annual updates for each year's budget and provides a tool for evaluating rate and financial impacts of proposed budget changes.

A. OVERVIEW OF RATE SETTING

As an enterprise fund, water operations are financed and operated as a distinct business. Appropriate fees and charges should be established to ensure that the water operations can operate on a self-sustaining basis. For a water utility, the majority of revenue is normally derived through user charges. These service fees, rates, and billings are charged to the beneficiaries of the water services. Development of a user charge system is defined as the total process of identifying costs, allocating costs to the water beneficiaries, and designing a rate structure to recover allocated costs.

B. COST OF SERVICE ANALYSIS

One of the key objectives was to evaluate the consistency of the existing water rate structure with the actual cost of service for each of the existing customer classes. In order to evaluate this, the Rate Model included a cost of service analysis based on FY10 as a test year to determine more appropriate allocation of costs among the customer classes.

The total cost of water service is analyzed by system function in order to equitably distribute costs of service to the various classes of customers. For this analysis, water utility costs of service are assigned to three basic functional cost components: base costs, extra capacity costs, and customer service related costs.

Base costs are those operating and capital costs of the water system associated with serving customers at a constant average rate of use. Extra capacity costs represent those operating and capital costs incurred to meet customer peak demands for water in excess of average day usage. Total extra capacity costs are subdivided into costs associated with maximum day and maximum hour demands. RFC used the District's peaking factors to allocate among base, maximum day and maximum hour, shown below in Table 5-1.

TABLE 5-1
SYSTEM PEAKING FACTORS

	<u>Demand Factors</u>
Base	1.00
Max Day	1.70
Max Hour	3.00

Customer costs are subdivided into customer service and meter costs. Customer service costs are uniform for all customers and include expenses such as meter reading, billing, accounts receivables, and accounting. Meter costs include maintenance and capital costs associated with meters and services. These costs are assigned based on meter size or meter capacity. In addition, some of the peaking costs may be assigned to meter costs to ensure a stable source of revenues. The separation of costs of service into these principal components provides the means for further allocation of such costs to the customer classes on the basis of their demands.

The total FY10 cost of service to be recovered from the District's users, shown on the following page in Table 5-2 on line 10, is estimated at nearly \$11.3 million, of which approximately \$9.5 million is in operating costs and the remaining in capital costs. The cost of service analysis is based upon the premise of generating annual revenues adequate to meet the estimated annual revenue requirements. Deductions from revenue requirements include miscellaneous operating revenues and interest revenue. Adjustments are also made to account for cash balances and mid-year rate increases to avoid collecting more revenue than is shown in the operating cash flow. This methodology ensures revenue neutrality, and adjusts requirements based on changing costs for operations and capital.

C. UNIT COSTS OF SERVICE

In order to allocate costs of service to the different user classes, unit costs of service need to be developed for each cost category. The unit costs of service are developed by dividing the total annual costs allocated to each parameter by the total annual units of the respective category.

TABLE 5-2
FY 08 COST OF SERVICE TO BE RECOVERED FROM RATES

Line No.	Revenue Requirements	Operating Expense \$	Capital Cost \$	Total \$
1	O&M Expenses	9,389,965		9,389,965
2	Debt Service		1,758,863	1,758,863
3	Transfer to Rate Stabilization	100,000		100,000
4	Subtotal	9,489,965	1,758,863	11,248,828
Less Revenue Requirements Met from Other Sources				
5	Misc. Operating Revenues	1,418,045		1,418,045
6	Subtotal	1,418,045	-	1,418,045
Less Adjustments				
7	Adjustment for Annual Cash Balance	(558,091)		(558,091)
8	Adjustment to Annualize Rate Increase	(863,000)		(863,000)
9	Subtotal	(1,421,091)	-	(1,421,091)
10	Cost of Service to be Recovered from Rates	9,493,011	1,758,863	11,251,874

Different units are used for the different cost categories. The volume related cost categories are based on volumetric units of one hundred cubic feet. The extra capacity categories of maximum day and maximum hour are based on a rate of usage so they are calculated in hcf per day and per hour. Customer service related cost categories are based on accounts and meter-related costs on equivalent meters.

Once the total number of units is known they can be used to calculate unit costs. The allocated costs are simply divided by the total number of units for each category to determine the unit costs of each category.

D. PROPOSED WATER RATE STRUCTURE AND RATES

The proposed water rates were designed to adjust the volumetric rates charged to each customer class to be more consistent with the actual cost of service differences among the residential and remaining classes. The revised rates also attempt to more accurately identify costs that should be recovered through the bi-monthly meter charges versus volume charges. A bi-monthly meter charge will continue to be assessed to each customer and will vary depending on the customer's meter size. The bi-monthly meter charge includes a customer service component and a meter cost component. In addition to the maintenance and costs related to meters and services, the meter cost component is adjusted to recover a portion of capital costs. The meter cost component varies based on meter size by reflecting the difference in potential demand that can be placed on the system by different sized meters. The remaining revenue requirements will be recovered

from a volumetric or consumption charge. The volume rate per hundred cubic feet varies by customer class. Details and proposed modifications to the commodity rate structure are outlined in the following sections.

Single Family Residential Commodity Rates: RFC recommends that the District retain its four-tier inclining rate structure for SFR customers. The District's existing tiers—at 12, 20 and 40 units (a unit is equal to 100 cubic feet or 748 gallons) bi-monthly—allow for sufficient usage for many of its customers before they are billed at the higher rates. This will continue to ensure that customers can meet essential usage needs, while those using water beyond that will pay the higher tiers. This will send a strong signal for conservation as large consumers of water will pay larger bills. SFR with Agriculture and SFR with Commercial customers will have the identical rate structure as SFR customers except they will have a reduced rate in the fourth tier. The proposed rates are summarized in Table 5-3.

Multi Family Residential Commodity Rates: RFC recommends that the District retain its four-tier inclining rate structure for MFR customers. The tiers allow for essential usage while sending a strong pricing signal for conservation. MFR with Agriculture and MFR with Commercial will have a rate structure identical to the MFR customers except for the lower fourth tier. The proposed rates are summarized in Table 5-3.

Commercial: RFC recommends that the District retains the uniform commodity rate for this customer (which includes those designated as Public and Government by the District) class since these customers are very non-homogenous and it is difficult to apply a standard tiered rate structure to these customers without being overly-punitive to large customers. In addition, they are motivated to control costs and therefore limit unnecessary water use. Also, their lower peaking characteristics result in lower average rates than for the residential class. The proposed rates are summarized in Table 5-3.

Landscaping and Construction: These customers typically have high peaking factors. RFC recommends keeping them as individual customer classes so that their rates can be set to reflect the cost of extra system capacity needed to serve them. The proposed rates are summarized in Table 5-3.

Agricultural: The District's Agricultural customers use drip irrigation systems on a more continuous basis than commercial customers resulting in lower peaking factors. The proposed rates are summarized in Table 5-3.

Recycled: Recycled water customers will continue to pay 85% of the equivalent potable rate shown in Table 5-3. Similarly, during drought conditions these customers will pay 85% of the equivalent drought rate shown in Tables 5-9 and 5-10.

**TABLE 5-3
CURRENT AND PROPOSED RATES**

Bi-Monthly Service Charge			
Meter Size	Existing Service Charge	Proposed Service Charge 3/1/2010	Proposed Service Charge 1/1/2011
5/8" & 3/4"	\$ 27.52	\$ 29.67	\$ 33.53
1"	\$ 44.00	\$ 47.18	\$ 53.31
1 1/2"	\$ 85.21	\$ 90.96	\$ 102.78
2"	\$ 134.67	\$ 143.48	\$ 162.13
3"	\$ 250.07	\$ 266.05	\$ 300.64
4"	\$ 423.80	\$ 441.14	\$ 498.49
6"	\$ 827.04	\$ 878.88	\$ 993.13
8"	\$ 1,343.74	\$ 1,404.17	\$ 1,586.71

Commodity Rates (per hcf)				
Customer Class	Blocks	Existing Rates	Proposed 3/1/2010	Proposed 1/1/2011
SFR	0-12	\$ 1.79	\$ 2.00	\$ 2.26
	13-20	\$ 2.45	\$ 2.98	\$ 3.37
	21-40	\$ 3.07	\$ 3.52	\$ 3.98
	41+	\$ 3.72	\$ 4.45	\$ 5.03
MFR	0-8	\$ 1.79	\$ 2.00	\$ 2.26
	9-12	\$ 2.45	\$ 2.98	\$ 3.37
	13-16	\$ 3.07	\$ 3.52	\$ 3.98
	17+	\$ 3.72	\$ 4.45	\$ 5.03
Agriculture		\$ 2.26	\$ 2.48	\$ 2.80
Commercial		\$ 2.49	\$ 2.80	\$ 3.16
Landscaping		\$ 3.04	\$ 3.52	\$ 3.98
Public		\$ 2.49	\$ 2.80	\$ 3.16
Government		\$ 2.49	\$ 2.80	\$ 3.16
Excess Use		\$ 3.04	\$ 3.52	\$ 3.98
Construction		\$ 3.04	\$ 3.52	\$ 3.98

Note: Residential with Agriculture or Commercial customers pay the same respective rates except for the last tier which reverts to the lower Agriculture or Commercial rate.

Recycled water customers will pay at 85 percent of the applicable potable rate.

Over the past few years, the District has realized a target percentage of 25% for its fixed rate revenue. These proposed rates will ensure fixed rate revenue remains at 25%. This will continue to have a stabilizing effect on the District's revenue in case of disruptive events such as large increases in water costs, increased drought conditions, and disruptions in local water supply.

E. CUSTOMER RATE IMPACTS

An important component of the rate study was an analysis of how the proposed rate structure would impact the bi-monthly bills of water customers. RFC worked closely with

District staff to ensure that appropriate revenue requirements would be recovered, while still paying close attention to the related impacts on customers.

The proposed water rate structure results in meter charges and different volume charges for all customer classes. Tables 5-4 through 5-8 demonstrate the impacts of the proposed rates on the District's regular potable customers across varying usage levels.

**TABLE 5-4
FY 10 BI-MONTHLY SFR RATE IMPACT – 3/4” METER**

Bi-Monthly Usage	Existing Charges	Proposed Charges	% Increase	\$ Increase
12	\$ 49.00	\$ 53.67	9.5%	\$ 4.67
18	\$ 63.70	\$ 71.55	12.3%	\$ 7.85
24	\$ 80.88	\$ 91.59	13.2%	\$ 10.71
30	\$ 99.30	\$ 112.71	13.5%	\$ 13.41
34	\$ 111.58	\$ 126.79	13.6%	\$ 15.21
42	\$ 137.44	\$ 156.81	14.1%	\$ 19.37
48	\$ 159.76	\$ 183.51	14.9%	\$ 23.75
66	\$ 226.72	\$ 263.61	16.3%	\$ 36.89
80	\$ 278.80	\$ 325.91	16.9%	\$ 47.11
100	\$ 353.20	\$ 414.91	17.5%	\$ 61.71

30 units = Average SFR Usage

**TABLE 5-5
FY 10 BI-MONTHLY MFR RATE IMPACT – 3/4” METER (4 unit building)**

Bi-Monthly Usage	Existing Charges	Proposed Charges	% Increase	\$ Increase
4	\$ 14.04	\$ 15.42	9.8%	\$ 1.38
7	\$ 19.41	\$ 21.42	10.3%	\$ 2.01
10	\$ 26.10	\$ 29.38	12.6%	\$ 3.28
12	\$ 31.00	\$ 35.34	14.0%	\$ 4.34
14	\$ 37.14	\$ 42.38	14.1%	\$ 5.24
18	\$ 50.72	\$ 58.32	15.0%	\$ 7.60
22	\$ 65.60	\$ 76.12	16.0%	\$ 10.52
25	\$ 76.76	\$ 89.47	16.6%	\$ 12.71
28	\$ 87.92	\$ 102.82	16.9%	\$ 14.90
34	\$ 110.24	\$ 129.52	17.5%	\$ 19.28

14 units = Average MFR Usage

TABLE 5-6
FY 10 BI-MONTHLY COMMERCIAL RATE IMPACT – 1” METER

Bi-Monthly Usage	Existing Charges	Proposed Charges	% Increase	\$ Increase
25	\$ 106.25	\$ 117.04	10.15%	\$ 10.79
50	\$ 168.50	\$ 186.89	10.91%	\$ 18.39
100	\$ 293.00	\$ 326.60	11.47%	\$ 33.60
125	\$ 355.25	\$ 396.46	11.60%	\$ 41.21
150	\$ 417.50	\$ 466.31	11.69%	\$ 48.81
175	\$ 479.75	\$ 536.17	11.76%	\$ 56.41
200	\$ 542.00	\$ 606.02	11.81%	\$ 64.02

TABLE 5-7
FY 10 BI-MONTHLY LANDSCAPING RATE IMPACT – 2” METER

Bi-Monthly Usage	Existing Charges	Proposed Charges	% Increase	\$ Increase
50	\$ 286.67	\$ 319.28	11.37%	\$ 32.61
100	\$ 438.67	\$ 495.07	12.86%	\$ 56.40
150	\$ 590.67	\$ 670.87	13.58%	\$ 80.20
200	\$ 742.67	\$ 846.66	14.00%	\$ 103.99
250	\$ 894.67	\$ 1,022.46	14.28%	\$ 127.79
300	\$ 1,046.67	\$ 1,198.25	14.48%	\$ 151.58
350	\$ 1,198.67	\$ 1,374.05	14.63%	\$ 175.38
400	\$ 1,350.67	\$ 1,549.84	14.75%	\$ 199.17

TABLE 5-8
FY 10 BI-MONTHLY AGRICULTURAL RATE IMPACT – 2” METER

Bi-Monthly Usage	Existing Charges	Proposed Charges	% Increase	\$ Increase
50	\$ 247.67	\$ 267.46	7.99%	\$ 19.79
100	\$ 360.67	\$ 391.44	8.53%	\$ 30.77
150	\$ 473.67	\$ 515.42	8.81%	\$ 41.75
200	\$ 586.67	\$ 639.40	8.99%	\$ 52.73
250	\$ 699.67	\$ 763.38	9.11%	\$ 63.71
300	\$ 812.67	\$ 887.36	9.19%	\$ 74.69
350	\$ 925.67	\$ 1,011.34	9.25%	\$ 85.67
400	\$ 1,038.67	\$ 1,135.32	9.31%	\$ 96.65

F. DROUGHT RATES

At present, District customers are being required to reduce consumption by 8% due to drought conditions. Year to date records suggest District customers are complying with the cutback and will possibly cut back even more. The rate analyses and calculations conducted in the previous sections were under the assumption of a non-drought scenario. Accordingly, in addition to the base rate scenario outlined in the previous section, we developed drought rates that can be implemented at any drought stage up to a 50% reduction.

Setting rates for such conditions involves the following steps. First, the variable expenses that would decrease due to reduced consumption are deducted from the base scenario rate revenue requirement. The next step involves making estimates on how the drought scenarios would impact consumption patterns and, therefore, the rate revenue stream. For example, higher level SFR users have a greater ability to conserve due to having more discretionary water usage. The following two tables (5-9 and 5-10) outline the commodity drought rates (bi-monthly fixed charges remain as outlined in Table 5-3) calculated for five stages of drought in FY10 and FY11. Drought stages that fall in between these levels (as the current 8% reduction does) are pro-rated in between the two scenarios in which it falls.

**TABLE 5-8
PROPOSED DROUGHT RATES FOR FY10**

	Stage:	No Reduction \$	8% Reduction \$	10% Reduction \$	20% Reduction \$	30% Reduction \$	40% Reduction \$	50% Reduction \$
SFR	0-12	2.00	2.15	2.19	2.40	2.75	3.28	4.01
	13-20	2.98	3.21	3.26	3.58	4.10	4.89	5.98
	21-40	3.52	3.79	3.86	4.22	4.84	5.78	7.06
	41+	4.45	4.79	4.87	5.34	6.12	7.31	8.93
SFR w/ Ag	0-12	2.00	2.15	2.19	2.40	2.75	3.28	4.01
	13-20	2.98	3.21	3.26	3.58	4.10	4.89	5.98
	21-40	3.52	3.79	3.86	4.22	4.84	5.78	7.06
	41+	2.48	2.58	2.60	2.76	2.96	3.23	3.60
SFR w/ Comm.	0-12	2.00	2.15	2.19	2.40	2.75	3.28	4.01
	13-20	2.98	3.21	3.26	3.58	4.10	4.89	5.98
	21-40	3.52	3.79	3.86	4.22	4.84	5.78	7.06
	41+	2.80	2.92	2.95	3.15	3.41	3.75	4.23
MFR	0-8	2.00	2.15	2.19	2.40	2.75	3.28	4.01
	9-12	2.98	3.21	3.26	3.58	4.10	4.89	5.98
	13-16	3.52	3.79	3.86	4.22	4.84	5.78	7.06
	17+	4.45	4.79	4.87	5.34	6.12	7.31	8.93
MFR w/ Ag	0-8	2.00	2.15	2.19	2.40	2.75	3.28	4.01
	9-12	2.98	3.21	3.26	3.58	4.10	4.89	5.98
	13-16	3.52	3.79	3.86	4.22	4.84	5.78	7.06
	17+	2.48	2.58	2.60	2.76	2.96	3.23	3.60
MFR w/ Comm.	0-8	2.00	2.15	2.19	2.40	2.75	3.28	4.01
	9-12	2.98	3.21	3.26	3.58	4.10	4.89	5.98
	13-16	3.52	3.79	3.86	4.22	4.84	5.78	7.06
	17+	2.80	2.92	2.95	3.15	3.41	3.75	4.23
Agriculture		2.48	2.58	2.60	2.76	2.96	3.23	3.60
Commercial		2.80	2.92	2.95	3.15	3.41	3.75	4.23
Landscaping		3.52	3.71	3.76	4.06	4.44	4.96	5.67
Public		2.80	2.92	2.95	3.15	3.41	3.75	4.23
Government		2.80	2.92	2.95	3.15	3.41	3.75	4.23
Excess Use		3.52	3.71	3.76	4.06	4.44	4.96	5.67
Construction		3.52	3.71	3.76	4.06	4.44	4.96	5.67

The 8% column reflects the rates for the current restriction level.

Recycled water customers will pay at 85 percent of the applicable potable rate.

**TABLE 5-9
PROPOSED DROUGHT RATES FOR FY11**

Stage:		No Reduction \$	8% Reduction \$	10% Reduction \$	20% Reduction \$	30% Reduction \$	40% Reduction \$	50% Reduction \$
SFR	0-12	2.26	2.43	2.48	2.71	3.11	3.71	4.54
	13-20	3.37	3.62	3.69	4.04	4.63	5.53	6.76
	21-40	3.98	4.28	4.36	4.77	5.47	6.53	7.98
	41+	5.03	5.41	5.51	6.03	6.91	8.26	10.09
SFR w/ Ag	0-12	2.26	2.43	2.48	2.71	3.11	3.71	4.54
	13-20	3.37	3.62	3.69	4.04	4.63	5.53	6.76
	21-40	3.98	4.28	4.36	4.77	5.47	6.53	7.98
	41+	2.80	2.91	2.94	3.12	3.35	3.65	4.07
SFR w/ Comm.	0-12	2.26	2.43	2.48	2.71	3.11	3.71	4.54
	13-20	3.37	3.62	3.69	4.04	4.63	5.53	6.76
	21-40	3.98	4.28	4.36	4.77	5.47	6.53	7.98
	41+	3.16	3.30	3.34	3.56	3.85	4.24	4.78
MFR	0-8	2.26	2.43	2.48	2.71	3.11	3.71	4.54
	9-12	3.37	3.62	3.69	4.04	4.63	5.53	6.76
	13-16	3.98	4.28	4.36	4.77	5.47	6.53	7.98
	17+	5.03	5.41	5.51	6.03	6.91	8.26	10.09
MFR w/ Ag	0-8	2.26	2.43	2.48	2.71	3.11	3.71	4.54
	9-12	3.37	3.62	3.69	4.04	4.63	5.53	6.76
	13-16	3.98	4.28	4.36	4.77	5.47	6.53	7.98
	17+	2.80	2.91	2.94	3.12	3.35	3.65	4.07
MFR w/ Comm.	0-8	2.26	2.43	2.48	2.71	3.11	3.71	4.54
	9-12	3.37	3.62	3.69	4.04	4.63	5.53	6.76
	13-16	3.98	4.28	4.36	4.77	5.47	6.53	7.98
	17+	3.16	3.30	3.34	3.56	3.85	4.24	4.78
Agriculture		2.80	2.91	2.94	3.12	3.35	3.65	4.07
Commercial		3.16	3.30	3.34	3.56	3.85	4.24	4.78
Landscaping		3.98	4.19	4.24	4.58	5.02	5.60	6.41
Public		3.16	3.30	3.34	3.56	3.85	4.24	4.78
Government		3.16	3.30	3.34	3.56	3.85	4.24	4.78
Excess Use		3.98	4.19	4.24	4.58	5.02	5.60	6.41
Construction		3.98	4.19	4.24	4.58	5.02	5.60	6.41

Recycled water customers will pay at 85percent of the applicable potable rate.

G. FIRE SERVICE CHARGES

Fire service systems, including hydrants, automatic sprinkler systems, standpipes, etc., benefit the properties being served by improving control over fire, decreasing damage to property and injury to personnel, and reducing insurance costs. This benefit may be based on the value of the property. However, to avoid conflicts in assessing real estate and personal properties, the value of this service is based on the cost of providing service rather than on the value of the protection offered to the customer. The District currently does not charge directly for public fire service. The fire service capacity is provided to all customers and absorbed in the water service charges of the District.

The District has to size its system to provide fire service. There are costs associated with maintenance of the system to provide this service. These costs are shared between public and private services in proportion to the demand they place on the system. Costs to the public system are redistributed in the service charges. The charges for private fire service are then determined for the several different sizes of private fire service connections. A schedule of private fire service charges is shown in Table 5-10.

TABLE 5-10
PROPOSED BI-MONTHLY PRIVATE FIRE SERVICE CHARGES

Meter Size	Existing Service Charge	Proposed Service Charge 3/1/2010	Proposed Service Charge 1/1/2011
1"	\$ 5.34	\$ 6.23	\$ 7.05
1 1/2"	\$ 10.21	\$ 11.63	\$ 13.14
2"	\$ 18.61	\$ 20.93	\$ 23.65
3"	\$ 48.74	\$ 54.32	\$ 61.38
4"	\$ 100.71	\$ 111.91	\$ 126.46
6"	\$ 287.24	\$ 318.59	\$ 360.01
8"	\$ 608.97	\$ 675.08	\$ 762.84

H. COMPARISON OF SERVICE CHARGES WITH SURROUNDING UTILITIES

At a usage level of 30 hcf per bill (bi-monthly), the District's SFR customers are currently charged \$99.30 per bill for water services. Under the proposed rate structure and drought rate implementation (assuming an 8% cutback) this charge would increase to \$119.06. Figure 5-1 compares the proposed charges to the charges expected to be in place at a group of surrounding utilities.

FIGURE 5-1
BI-MONTHLY BILL COMPARISON WITH SURROUNDING AGENCIES
Single Family Dwelling (30 hcf usage, 3/4" meter)

