TO: BOARD OF DIRECTORS

FROM: BRUCE BUEL BBB

DATE: JULY 20, 2007

AGENDA ITEM
E-3
JULY 25, 2007

RECEIVE DRAFT COMBINED WATER SYSTEM FINANCIAL PLAN

ITEM

Receive draft Combined Water System Financial Plan and User Rate Evaluation, Order Edits and Set Workshop for Public Feedback [RECOMMEND ADOPTION].

BACKGROUND

In January, your Honorable Board authorized staff to solicit a quote from the Reed Group to perform a water system rate study and on April 11, 2007, your Honorable Board retained Bob Reed of the Reed Group to execute the scope of work resulting from the District's solicitation. Both the Black Lake Village Council and your Honorable Board agreed to merge the Black Lake Water Fund with the Town Water Fund based on the equity adjustments determined through this process and the combined rates to become effective in early 2008.

Attached is Mr. Reed's 7/19/2007 submittal. Mr. Reed is scheduled to present this report to the Board at 11am. Although the adopted scope of work calls for the Reed Group to provide rate setting recommendations for a three year period (2008, 2009, and 2010), the attached rate study uses a five year planning horizon. The two years outside of this rate setting effort (2011 and 2012) are evaluated for study purposes only.

In regards to the equity study, Mr. Reed is recommending that the Black Lake customers should pay an equity surcharge of $1,672 to the Combined Fund to reconcile the differential in investment between the two systems. If this recommended Surcharge were paid over a ten year period, the typical Black Lake 1" meter customer would pay $35.52 every two months in addition to the combined water charge.

In regards to the proposed combined system rates, Mr. Reed is recommending that the 2008 rates increase by 12% (Town System rates would otherwise increase by 10% and Black Lake rates would otherwise increase by 18%). For 2009, Mr. Reed is recommending that the combined rates increase by 12% (Town System rates would otherwise increase by 8% and Black Lake rates would otherwise increase by 18%). For 2010, Mr. Reed is recommending that the combined rates increase by 12%.

In regards to the rate structure, Mr. Reed's report presents one possible change from its existing Bi-Monthly Base Rate plus Tier 1 (0 to 10 units or 748 gallons) commodity charge plus Tier 2 (over 40 units) commodity charge to a rate structure with a base charge and then four rate tiers:

- Tier 1 – Median Winter Use Tier - 0 to 27 units (330 gpd)
- Tier 2 – Media Peak Summer Use – 28 to 48 units (590 gpd)
- Tier 3 – 85th Percentile Peak Summer Use – 49 to 104 units (1,275 gpd)
- Tier 4 – Excess Use – Over 104 Units

Mr. Reed will present alternative rate structure models at the Board Meeting.

Once your Honorable Board completes its review of the report and provides feedback to Mr. Reed, Mr. Reed will then respond with a revised report within two weeks. If your Board reaches

closure at this meeting, then Mr. Reed will submit a revised report by August 8, 2007 so that staff can prepare and mail out Proposition 218 Notices in time for the community meetings (staff rather than Board Meetings) tentatively scheduled for August 28, 2007. Feedback from these meetings would be incorporated into the revised recommendations presented to your Board at your October 10th Board Meeting. Should your Honorable Board revise rates in October, the new 2008 rates would become effective on January 1, 2008.

Also attached is a comparison of NCSD's Water Rates with the rates charged by other local purveyors. The comparison is based on the cost to the average NCSD user.

RECOMMENDATION

Staff recommends that your Honorable Board receive Mr. Reed's presentation, receive public comment, and then order edits to the Report. Should your Board reach closure at this meeting, staff should be authorized to prepare the Proposition 218 notices in time for the August 28th Workshops.

ATTACHMENTS

- Draft Reed Rate Study
- Water Rate Survey

T:\BOARD MATTERS\BOARD MEETINGS\BOARD LETTER\BOARD LETTER 2007\Reed Water Rate Survey.DOC

Nipomo Community Services District

COMBINED WATER SYSTEM

FINANCIAL PLAN AND

USER RATES

DRAFT REPORT

July 19, 2007

THE REED GROUP, INC.

TABLE OF CONTENTS

I. Executive Summary

Introduction

In 2005, The Reed Group, Inc. assisted the Nipomo Community Services District with the development of five-year financial plans for the District's water and sewer utilities. In the spring of 2007 the Nipomo Community Services District retained The Reed Group, Inc. to update financial plans and water and sewer rate recommendations for the District's Town and Blacklake Divisions. The District is considering merging the two water divisions together. This report presents analyses related to combined merging the Town and Blacklake water systems and presents a combined financial plan and water rate recommendations for the combined water systems, as well as recommends an equity surcharge for customers of the Blacklake Division that would make their investment in the water system equivalent to that already made by customers of the Town Division. Finally, this report also presents an analysis of alternative water rate structures intended to help the District meet water conservation and other objectives through refinements to the rate structure. Financial plans and sewer rate recommendations for the Town and Blacklake sewer systems are presented in separate reports.

The District is committed to securing supplemental water to mitigate the impacts groundwater usage has on the underlying groundwater basin. In September 2004, the District signed a Memorandum of Understanding (MOU) with the City of Santa Maria to acquire up to 3,000 acre-feet (AF) of water per year. In order to use water from the City of Santa Maria the District will need to construct transmission facilities to convey water to the District's service area. Plans for the most cost-effective means of conveying supplemental water are still in development. However, the financial plan presented herein includes the District's best current estimates for the cost of the project and the manner in which it may be financed. Water system buy-in and supplemental water capacity charges are not updated in this report. However, the District should consider updating these charges once plans for the supplemental water project are firmed up.

A portion of the supplemental water pipeline project is expected to be financed with long-term debt. In addition to ensuring that each of the combined water system is covering appropriate operating costs and capital program needs, the financial analysis also addresses the need to meet debt service obligations, including debt service coverage. While debt service associated with the supplemental water pipeline project is expected to paid from supplemental capacity charge revenues, debt service payments must also be secured by water rates.

The remainder of this Executive Summary presents primary findings and recommendations related to the (1) Blacklake equity surcharge, (2) combined water system financial plan, and (3) water rates for both the combined water system. Section II provides details on the financial plans. Section III presents water rate calculations, including the equity surcharge and discussion of alternative water rate structures.

Equity Surcharge

Existing customers of the Town and Blacklake water systems have each contributed to the construction, operation, and maintenance of their respective water systems based on the requirements of each system. In considering the merger of the two water systems, the District's

Board of Directors requested an analysis of the relative investment made, per customer[1], in both the Town and Blacklake water systems. The objective is to require whichever customers have a lesser investment in the water systems to make an additional contribution to establish equity and parity for all customers of the combined system. To achieve this, the book value of water system assets, as well as financial reserves, based the last audited financial statements (as of June 30, 2006) were expressed on a per customer basis. Then, an equity surcharge was calculated based on the difference between the relative investments within each water system.

Customers of the Town water system have a current investment of about $4,272 per equivalent meter, whereas customers of the Blacklake water system have a current investment of about $2,600. Therefore, to establish equity between customers in a combined water system an equity surcharge of $1,672 per 1" equivalent meter paid by Blacklake customers is appropriate. The equity surcharge includes both investments in water system facilities, as well as cash reserves. About 20 percent of the equity surcharge reflects differences in capital investments and 80 percent is associated with differences in cash reserves.

Exhibit I-1 summarizes the results of this calculation. The proposed equity surcharge is presented either as a lump sum amount or as a bi-monthly payment that would be imposed for a one-, two-, five-, or ten-year period. A five percent interest rate is included on any equity surcharge payments to be made over time. Details of the Blacklake equity surcharge are included in Section III of this report.

Exhibit I-1
Nipomo Community Services District
Proposed Blacklake Equity Surcharges

	Meter Size		
	Up to 1"	1 1/2"	2"
Lump Sum Payment	$ 1,672	$ 5,015	$ 8,025
Alternative Bi-Monthly Payments			
For 1-Year	$ 286.82	$ 860.45	$ 1,376.72
For 2-Years	$ 146.98	$ 440.93	$ 705.49
For 5-Years	$ 63.21	$ 189.64	$ 303.42
For 10-Years	$ 35.52	$ 106.56	$ 170.50

Combined Water System Financial Plan

The financial plan for the combined water system was developed to cover a five-year planning period from FY 07-08 through FY 11-12. The financial plan includes estimated operating and maintenance costs, anticipated debt service obligations, and capital program needs, including requirements for implementing the supplemental water project.

The financial plan model was used to identify annual water rate revenue requirements for each year of the planning period. The revenue requirement is the amount needed to cover operating costs, debt obligations, and capital program needs with consideration of other revenues and

[1] The number of customers is expressed in terms of the number of equivalent 1" meters, which takes into account the higher relative demands that can be placed on the water system by customers with large meters.

financial reserves. Annual rate increases are based on the estimates of current and future costs provided by the District. Analyses sought to develop a financial strategy that would help to minimize the magnitude of annual water rate increases, while still meeting financial obligations.

The financial plan model is intended to serve a planning and management tool to assist the District in evaluating the current and future needs of the water utility. Underlying assumptions, financial objectives, and the proposed financial strategies are described in Section II of this report. Significant findings and recommendations resulting from the financial planning efforts are presented below.

- Current revenues exceed current expenditures and capital program transfers, which results in an increasing Operating Fund balance. However, this situation will change with the implementation of the supplemental water project.

- The beginning-of-year (FY 07-08) Operating Fund balance is about $1,570,000 with a target Operating Reserve of $1,160,000.

- The District continues to annually transfer an amount equal to depreciation into the Funded Replacement Fund. The fund has adequate cash for planned replacement and upgrade projects for the five-year planning period, and can also contribute $2,500,000 towards the financing of the supplemental water project.

- Two remaining installment payments under the Memorandum of Understanding with the City of Santa Maria for supplemental water totaling $525,000 will likely to become due in FY 10-11.

- The cost of supplemental water will increase operating costs and water rates when it becomes available in 2011. Increased costs will be associated with supplemental water purchases, pumping, and treatment. These increased costs are reflected in the financial plan beginning in 2011.

- The District previously adopted water rate increases for January 2008 and January 2009 of 10 percent and 8 percent, respectively, for the Town Division and 18 percent and 18 percent for the Blacklake Division. Water rates in Blacklake are currently higher than they are for the Town Division. Rate recommendations presented in this report would supersede previously approved water rates.

The proposed financial strategy for the combined water system reflect the following changes:

- The proposed Blacklake equity charge is assumed to be paid by existing customers of Blacklake through bi-monthly service charges paid over a ten-year period. Revenues from the equity surcharge accrue to the Funded Replacement Fund.

- The supplemental water project is assumed to have a total cost of $15 million. It is also assumed that other water purveyors will contribute $5 million towards the cost of the project. It is recommended that the remaining $10 million in costs be funded as follows:

    - $4.0 million from Supplemental Water Fund reserves
    - $3.5 million from issuance of Certificates of Participation (COPs)
    - $2.5 million from Funded Replacement reserves

- Supplemental water capacity charge revenue should be sufficient to cover annual debt service payments. However, the District should update the supplemental water capacity charges once a project is sufficiently defined and costs have been updated. In addition, the District will likely need to set water rates such that the debt service payment obligations could be made in the absence of supplemental water capacity charges. Annual debt service is estimated to be about $350,000 per year based on the supplemental water project assumptions contained herein.

- Water rates for the combined water system should be increased as shown below. The rate increases are relative to the current Town Division water rates, which would be applied within Blacklake with the merger of the two water systems. Water rates in Blacklake would effectively be reduced (relative to previously approved water rates for both 2008 and 2009), and this reduction would offset the effects of the Blacklake equity surcharge. The litigation charges would not increase, but would continue until resolution of groundwater litigation issues.

January 2008	12%
January 2009	12%
January 2010	12%
January 2011	12%
January 2012	12%

Proposed Water Rate Schedules

This study included developing specific water rate structure recommendations for the next three years. Proposed future water rate schedules covering the three-year period are presented in **Exhibit I-2** for the combined water system. Proposed rates are intended to generate the revenues reflected in financial plan analyses. In addition, it is recommended that the water rate structures be changed such that the current two-tier single family rate structure is modified to include four tiers. Tier break points are recommended as follows for each bi-monthly billing period.

➢ First tier	0 to 27 HCF	Median winter use (330 gpd)
➢ Second tier	28 to 48 HCF	Median peak summer use (590 gpd)
➢ Third tier	49 to 104 HCF	85th percentile peak summer use (1,275 gpd)
➢ Fourth tier	Over 104 HCF	Excess use

No other changes to the water rate structures are proposed at this time. **[ALTERNATIVE TIER STRUCTURES WILL BE DISCUSSED DURING THE JULY 25 BOARD MEETING]**

The consolidation of water rates for the Town and Blacklake will result in different bill changes for customers of each area. Nevertheless, because the rate structures are generally the same the consolidation can be made at one time.

Proposed rate increases January 2009 and January 2010 are made without further rate structure changes. Therefore, all rate component are scheduled to increase by 12 percent in both 2009 and 2010.

Exhibit I-2
Nipomo Community Services District
Current and Proposed Water Rates

	Current Rates (1)		Proposed Combined Water Rates			Litigation
	Town	Blacklake	Jan. 2008	Jan. 2009	Jan. 2010	Charge (2)
Bi-Monthly Service Charges						
Up to 1"	$ 20.64	$ 22.08	$ 24.57	$ 27.52	$ 30.82	$ 6.32
1 1/2"	$ 58.60	$ 61.09	$ 70.15	$ 78.57	$ 88.00	$ 14.36
2"	$ 92.81	$ 96.24	$ 111.17	$ 124.51	$ 139.45	$ 19.92
3"	$ 172.68	$ 178.33	$ 206.88	$ 231.71	$ 259.52	$ 27.92
4"	$ 286.77	$ 295.58	$ 343.60	$ 384.83	$ 431.01	$ 36.00
6"	$ 571.73	$ 588.42	$ 685.36	$ 767.60	$ 859.71	$ 59.58
8"	$ 913.83	$ 939.98	$ 1,095.54	$ 1,227.00	$ 1,374.24	$ 68.08
Water Usage Rates ($/HCF)						
Single Family Residential						
Tier 1 (0-27 HCF)	$ 1.38	$ 1.42	$ 1.44	$ 1.61	$ 1.80	
Tier 2 (28-48 HCF)	$ 2.35	$ 2.49	$ 1.66	$ 1.86	$ 2.08	
Tier 3 (49-104 HCF)	(3)	(3)	$ 2.49	$ 2.79	$ 3.12	
Tier 4 (>104 HCF)			$ 3.74	$ 4.19	$ 4.69	
Non-Residential (4)						
All Usage	$ 1.74	$ 1.73	$ 1.91	$ 2.14	$ 2.40	

Notes:
(1) Effective January 1, 2007 as adopted with Ordinance 2005-103.
(2) No changes are proposed for the litigation charge, which applies to all water connections until resolution of groundwater litigati
(3) Under the current rates, the Tier 1 rate applies to the first 40 HCF and the Tier 2 rate applies to use in excess of 40 HCF.
(4) Includes multi-family, commercial, irrigation, agricultural, industrial, and construction.

Customer Bills Impacts of Proposed Rates

The specific change to rate components in January 2008 reflect the cost of service analysis and modifications to the residential water rate structure. As a result, the amount of change to individual water bills varies based on customer class, meter size, and water usage. The table below summarizes the proposed changes in various single family water bills for 2008.

Bi-Monthly Water Bills

	Current		Proposed for 2008		
	Town	Blacklake	Jan. 2008	Change for Town	Change for Blacklake
Low Use (24 HCF)	$ 60.08	$ 62.48	$ 65.45	$ 5.37	$ 2.97
Median Use (34 HCF)	$ 73.88	$ 76.68	$ 81.39	$ 7.51	$ 4.71
High Use (64 HCF)	$ 176.16	$ 184.80	$ 184.31	$ 8.15	$ (0.49)
Very High Use (120 HCF)	$ 270.16	$ 284.40	$ 303.91	$ 33.75	$ 19.51

II. Five-Year Financial Plan

This section of the report describes the combined water system five-year financial plan prepared for the Nipomo Community Services District. This section includes a description of fund and reserve structures and cash flows, financial plan assumptions including the capital improvement program and debt financing assumptions for capital projects, and a summary of the financial plan. Detailed exhibits of combined water system financial plan model are included in **Appendix A**, at the end of this report.

The financial plan is used to determine annual water rate revenue requirements. The annual rate revenue requirement is the amount of revenue needed from user rates to cover planned operating, maintenance, debt service, and capital program costs with consideration of other revenues, including capacity charges, as well as financial reserves.

Fund and Reserve Structures and Cash Flows

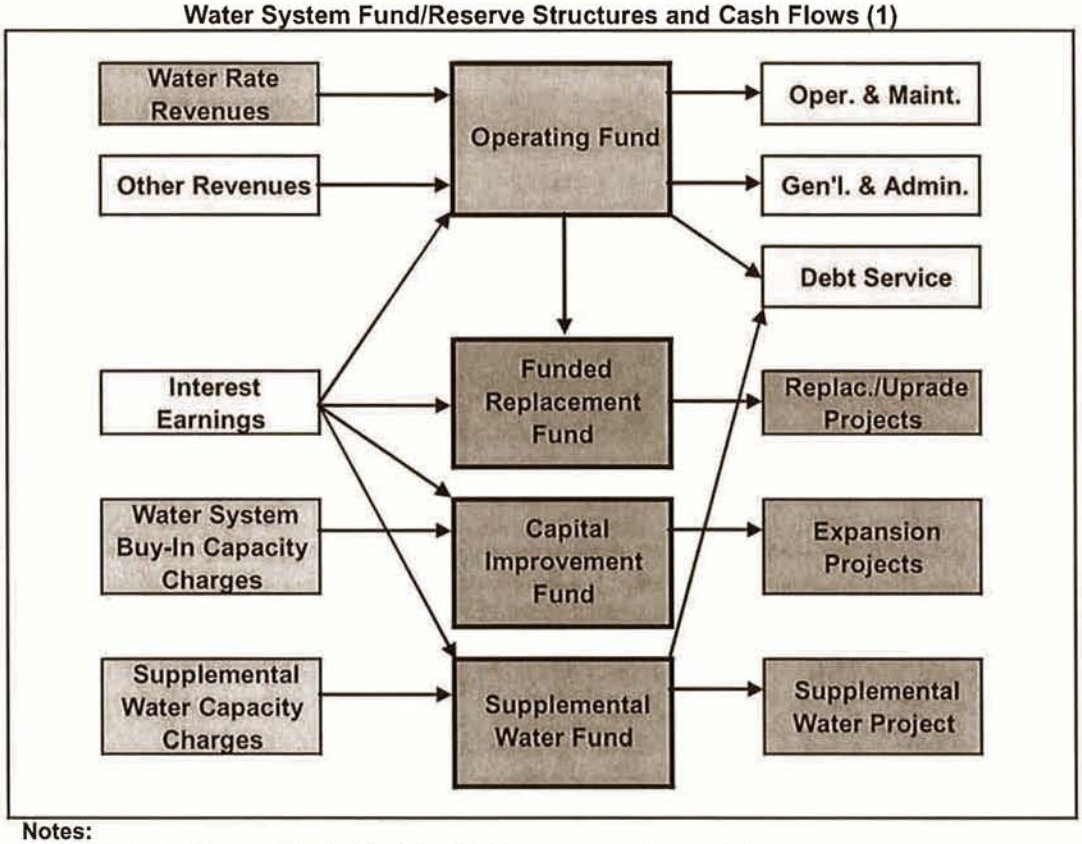
The financial plan is an annual cash flow model. As a cash flow model, it differs from standard accounting income statements and balance sheets. The financial plan models sources and uses of funds into, out of, and between the various funds and reserves of the water utility.

The financial plan model is based on the fund, reserve, and account structures currently used by the District. **Exhibit II-1** is a schematic diagram of the funds/reserves and major cash flows associated with the financial plan model.

An understanding of the fund/reserve structure is helpful in understanding the financial plan worksheets that model annual cash flows through the water utility from one year to the next. The fund/reserve structure is comprised of:

- ***Operating Fund*** – The Operating Fund is the primary fund within the water utility. Most of the water system's revenues, including rate revenues, flow into the Operating Fund and all operating and maintenance costs, including capital outlay items and debt service payments, are paid out of this fund. Funds are also transferred from the Operating Fund to the Funded Replacement Fund to fund capital projects intended to rehabilitate and upgrade facilities.
    - *Operating Reserve* – The District currently has a policy goal to maintain Operating Reserves within the Operating Fund equal to 50 percent of annual operating and maintenance costs for the water system. The purpose of the Operating Reserve is to provide working capital and funds for unplanned operating and maintenance expenditures. The balance in the combined water system Operating Fund is currently above the minimum target Operating Reserve.
    - *Uncommitted Fund Balance* – The balance in the Operating Fund in excess of the target amount for the Operating Reserve is shown in the financial plan exhibits (see Appendix A) as Uncommitted Fund Balance. After all other obligations are met the Uncommitted Fund Balance is available to offset rate increases, and the financial plan model generally seeks to reduce any Uncommitted Fund Balance over time.

Exhibit II-1
Nipomo Community Services District
Water System Fund/Reserve Structures and Cash Flows (1)



Notes:
(1) Excludes funds related to the 2003 COP proceeds and property taxes.

- ***Funded Replacement Fund*** – The Funded Replacement Fund is used to account for capital projects intended to rehabilitate or upgrade the water system. The primary source of money for the Funded Replacement Fund is a transfer from the Operating Fund. The District currently transfers an amount equal to annual depreciation into the Funded Replacement Fund.

- ***Capital Improvement Fund*** – The Capital Improvement Fund is used to account for revenues and expense related to the water system buy-in capacity charges. Capital projects funded from the Capital Improvement Fund are those needed for system expansion and to accommodate the needs of new development.

- ***Supplemental Water Project Fund*** – A separate fund was created by the District to account for supplemental water capacity charges and expenditures related to implementing the supplemental water supply. Proceeds from the anticipated COPs to be issued for the supplemental water pipeline project will be deposited into this fund. Supplemental water capacity charges will be applied against project costs and related debt service.

- ***Property Tax and 2003 COP Funds*** – The District also maintains funds to account for proceeds from the issuance of Certificates of Participation (COPs) in 2003 and also to

account for property tax revenues. Property taxes have been pledged for payment of debt service related to the 2003 COPs. While property taxes and the 2003 COPs were considered in financial analyses, they are independent of general operations and are not reflected in the exhibits contained in Appendix A.

Financial Plan Assumptions

The financial plan was created to reflect the proposed FY 07-08 budget and financial condition as of the beginning of the fiscal year. The financial plan also reflects planned capital improvement program expenditures, as identified by staff for the five-year planning period.

The process used to develop the financial plan involved estimating future revenues and expenditures based on growth projections, inflation and interest rates, anticipated capital improvement needs, and other information. The District does not have formal estimates of future operating and maintenance costs, and capital improvement needs are defined at a planning level. The financial plan is based on the best available information and assumptions are believed to be reasonable; however, no assurance can be provided as to the accuracy and completeness of the estimates.

Basic Assumptions

Exhibit II-2 summarizes the basic assumptions reflected in the financial plan model, as described below.

- *Inflation Rates* – Operating costs are inflated largely based on a factor for general inflation. An annual inflation rate of 3.0 percent was used for operational costs.

- *Interest Rates* – The District earns interest on its fund and reserve balances. Most of the District's available cash is invested in the Local Agency Investment Fund (LAIF). An annual return on fund and reserve balances is assumed to be 4.5 percent per year estimated on the beginning-of-year balances. The current interest earnings on funds deposited with LAIF is about 5.2 percent, however, the 4.5 percent assumption is more consistent with long-term averages. The assumption reflected herein is therefore somewhat conservative. The District also pays interest on debt obligations within the water utility. Interest rates and payments on existing obligations are those contained in existing contracts and repayment schedules. For future debt issues an annual interest rate of 6.0 percent is assumed.

- *Growth Projections* – For purposes of financial planning, a conservative annual customer growth rate of 1.0 percent is assumed for the Town Division and zero percent for the Blacklake Division. Actual growth is expected to be about 2.3 percent. However, because financial performance (in particular capacity charge revenue) is sensitive to the growth assumption, a lower assumption was used herein.

- *Water Conservation* – Average water use per account is assumed to decrease by 0.5 percent each year of the planning period. That is, customers will use, on average, slightly less water each year. Reduced water usage is expected to result from increased water conservation efforts (public education and outreach) as well as increased costs associated with water and sewer services.

Exhibit II-2
Nipomo Community Services District
Summary of Financial Plan Assumptions

Interest Earnings	4.5%					
General Inflation Rate	3.0%					
Operating Reserve - Water	50%	of operating expenditures				
Customer Growth Rate						
Town Division	1.0%	per year				
Black Lake Division	0.0%	per year				
Water Coservation Factor	0.5%	per year				
	FY 06-07	**FY 07-08**	**FY 08-09**	**FY 09-10**	**FY 10-11**	**FY 11-12**
No. of Accounts						
Town - Water	3,428	3,462	3,497	3,532	3,567	3,603
Blacklake - Water	589	589	589	589	589	589
Water System - Combined	4,017	4,051	4,086	4,121	4,156	4,192
Equivalent Meters	4,215	4,257	4,300	4,343	4,386	4,430
Water Sales						
Combined Water Sales (HCF)	1,137,593	1,143,000	1,149,000	1,155,000	1,161,000	1,167,000
Combined Water Sales (AF)	2,612	2,624	2,638	2,652	2,665	2,679
Sales per Acct. (AF)	0.65	0.65	0.65	0.64	0.64	0.64
Water Production by Source (AF)						
Mesa Groundwater	2,902	2,916	2,931	2,946	2,298	1,310
Supplemental Water	-	-	-	-	663	1,667
Total Water Production	2,902	2,916	2,931	2,946	2,961	2,977
Production per Acct.						
Unaccounted for Losses	10%	10%	10%	10%	10%	10%
Variable Water Supply Costs ($/AF)						
Groundwater Pumping	$ 175	$ 180	$ 185	$ 191	$ 197	$ 203
Supplemental Water					$ 1,200	$ 1,200
Supplemental Water Pumping					$ 96	$ 99
Supplemental Water Treatment					$ 13	$ 13
Capacity Charges						
Water Buy-In	$ 2,599	$ 2,713	$ 2,794	$ 2,878	$ 2,965	$ 3,054
Supplemental Water	$ 11,556	$ 12,062	$ 12,424	$ 12,797	$ 13,180	$ 13,576
Supplemental Water Project COPs (FY 08-09)						
Amount of Debt		4,000,000				
Net Proceeds		3,500,000				
Interest Rate		6.0%				
Term		20	years			
Annual Payment		348,738				

- *Customer Account and Water Use Data* – In developing the financial plan model, detailed customer account and water use data were obtained for the period from June 2006 through May 2007. Additional information on the current number and type of customers is provided in Sections III of this report.

- *Water Production* – Water sales are based on past sales and growth and conservation assumptions described above. Water production is greater than water sales due to unaccounted for system losses, which is typically in the range of 6 to 12 percent. While losses may vary, a loss rate of 10 percent has been assumed in the financial plan models. Currently groundwater comprises 100 percent of water supplies of the District's water supplies. The District is working to obtain supplemental water from the City of Santa Maria in order to mitigate impacts of groundwater withdrawals on the groundwater basin. The financial plan model reflects an assumption that by January 2011 about 56 percent of the

District's water supplies will come from supplemental water, with 44 percent from the existing groundwater basin.

- *Capacity Charge Revenues* – Capacity charge revenues reflected in the financial plans are based on the current capacity charge schedules, as well as customer growth and annual inflationary fee increases. The District annually increases capacity charges by the average change to the Consumer Price Indices for the San Francisco bay area and the Los Angeles area. Inflationary increases of 3.0 percent per year for capacity charges are included in this study.

Water Supplies

Currently the District obtains 100 percent of its water supply from groundwater from the Nipomo hydrologic sub-area of the greater Santa Maria groundwater basin. However, the District's use of groundwater is limited to having no impact on the basin's water supplies. As a result of recent legal actions to adjudicate the groundwater basin, the District has initiated steps to acquire supplemental water to mitigate the effects of groundwater withdrawals.

In September 2004, the District and City of Santa Maria entered into a Memorandum of Understanding (MOU) to establish terms and conditions for a contract for up to 3,000 AF per year of supplemental water from the City. Under the terms of the MOU the District must pay a $750,000 reservation fee in installments as presented below.

Installment	Amount	Est. Date
MOU Date	$37,500	Sept. 2004
Contract Date (after CEQA)	$187,500	Fall 2005
Construction Complete	$225,000	Fall 2010
First 300 AF Delivered	$300,000	Spring 2011

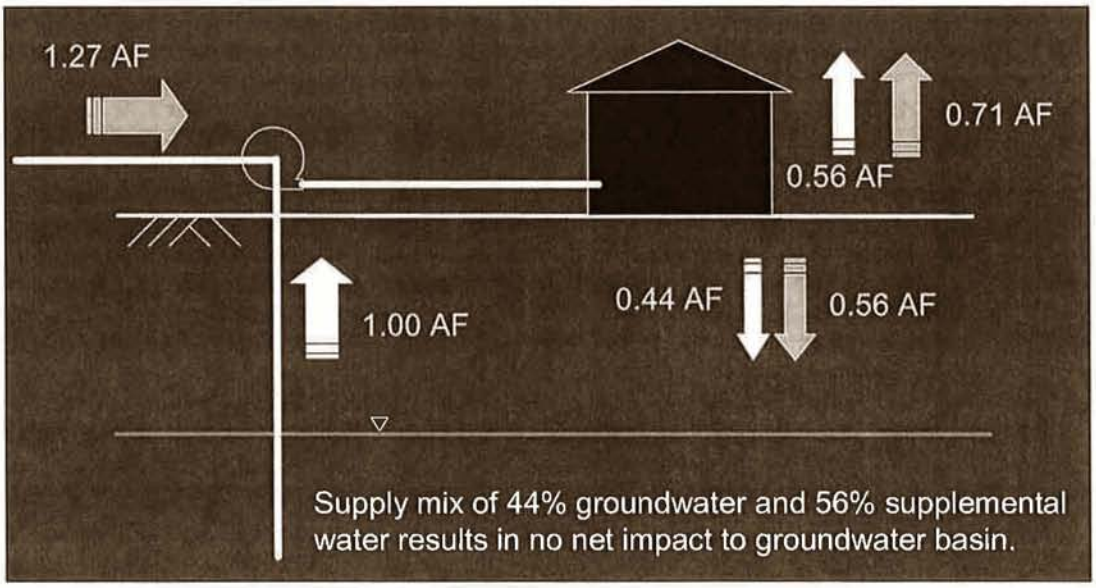
Water delivered under the agreement will cost $1,250 per AF, although the reservation fee will be credited back at $50 per AF over the first 15,000 AF delivered. The District needs to construct a transmission pipeline to convey water from the City to the District's service area.

In order to mitigate any impacts on the groundwater basin the District estimates that it will need a water supply mix of 44 percent groundwater and 56 percent supplemental water. As shown graphically in **Exhibit II-3**, for each AF of groundwater extracted from the basin an estimated 44 percent returns to the basin while 56 percent is consumed or otherwise leaves the basin. Each AF of imported supplemental water will add 44 percent to the basin, while 56 percent is consumed. The financial analyses presented herein assume that the District will utilize a 44 percent groundwater and 56 percent supplemental water supply mix beginning in January 2011.

Capital Improvement Program

At present, the District is nearing completion of a 20-year water system master plan and details for implementing the supplemental water project. For purposes of this study, District staff prepared a five-year capital improvement plan for the combined water system. Financial plan exhibits contain in Appendix A list each project, estimated cost, year of construction, and fund from which each project will be funded. Replacement/upgrade project costs are assigned to the Funded Replacement Fund, expansion costs are assigned to the Capital Improvement Fund, and supplemental water project costs are reflected in the Supplemental Water Fund.

Exhibit II-3
Nipomo Community Services District
Groundwater and Supplemental Water Supply Strategy



Supplemental Water Project Costs

As described above, the District is currently working to obtain 3,000 AF per year of supplemental water through a contract with the City of Santa Maria. A Memorandum of Understanding (MOU) calls for payments totaling $750,000 in several installments to solidify the contractual arrangement. In addition, the District has estimated that it may cost about $15 million to construct needed transmission facilities to convey supplemental water from the City to the District's service area. Water under the contract with Santa Maria would cost the District $1,250 per AF. This cost of water will be reduced by $50 per AF for the first 15,000 AF of water delivered as reimbursement of initial installment payments. Supplemental water pumping and treatment costs are estimated to add about $109/AF to the cost of supplemental water when deliveries begin in 2011.

In 2005 the District adopted a supplemental water capacity charge to provide funds for the supplemental water project. As of the beginning of FY 07-08 the Supplemental Water Fund has about $2.3 million. Annual supplemental water capacity charge and interest revenue is estimated to exceed $500,000 per year.

While the District is still developing plans for constructing needed facilities to convey supplemental water to the District's service area, the financial plan presented herein assumes a $15 million project cost, which will be financed as follows:

- $5 million paid by other water purveyors for 1,000 AF of the 3,000 AF capacity in the supplemental water pipeline
- $4 million from current Supplemental Water Fund reserves and anticipated future revenues

- $3.5 million from the issuance of Certificates of Participation (par amount about $4 million)
- $2.5 million from available reserves in the water system Funded Replacement Fund.

After construction of the supplemental water project future supplemental water capacity charge revenues are to be applied towards supplemental water COP debt service, to reimburse funds obtained from the Funded Replacement Fund, and to offset a portion of the cost of supplemental water purchases.

While not included within the scope of this project, the District should update the supplemental water capacity charge calculation once the supplemental water project is more clearly defined and more accurate cost estimates obtained. Current capacity charges are based on a project cost of about $6 million, with no debt financing.

As with the previous financial plan, the financial strategy herein assumes that the District will make 1,000 AF/year of conveyance capacity in the planned transmission facilities available to other purveyors, and that the purveyor(s) would pay a proportionate share of transmission facility costs. Details of any arrangement with other purveyors are unknown at this time and beyond the scope of this study.

Financial Plan Findings and Conclusions

The preceding portion of this section describes the basic framework and assumptions underlying financial analyses. Specific findings and conclusions pertaining to the combined water system is presented below, beginning with a description of the current situation.

Proposed increases to water rates are very close to those previously adopted for the Town Division water system. The current financial condition of the combined water utility is stronger than previously estimated at this point in time with the previous financial plan. This is largely due to the fact that the prior financial plan had assumed that the supplemental water project would be completed by now, with supplemental water deliveries beginning in FY 07-08.

Currently the Town Division's water system has:

- Budgeted expenditures and transfers that are less than current revenues, which results in a growing Operating Fund balance.
- A beginning-of-year (FY 07-08) Operating Fund balance of about $1,570,000, with a target Operating Reserve of $1,160,000.
- The combined water system Funded Replacement Fund has adequate cash for planned replacement and upgrade projects for the five-year planning period, and can also provide $2.5 million to help finance the supplemental water project.

Water rates and other Operating Fund revenues should normally cover all operating and maintenance costs, plus providing ongoing support for capital replacement and upgrade needs through annual transfers to the Funded Replacement Fund. Current water rates and other revenues meet this requirement. However, once the District begins receiving supplemental water from the City of Santa Maria annual operating costs will increase significantly. In addition, the District will need to maintain water rates and other revenues at levels sufficient to meet debt service coverage requirements. As a result, continued annual water rate increases are needed and recommended.

The proposed overall average annual rate increases needed to meet estimated financial obligations are shown below.

	Overall Average Rate Increase
January 2008	12%
January 2009	12%
January 2010	12%
January 2011	12%
January 2012	12%

At present, water rates generate about $2.66 million annually. Future supplemental water costs including pumping and treatment will total about $2.2 million annually, representing a potential increase in the annual water rate revenue requirement approaching 100 percent. However, the proposed supplemental water capacity charge (see Section V) should reduce the net cost of supplemental water to about $200,000 to $300,000 per year (after paying related supplemental water debt service), and groundwater pumping costs will be reduced more than $300,000 annually with reduced groundwater pumping. Therefore, the proposed rate increases should be sufficient to cover the added cost of supplemental water through the planning period. Details of proposed changes to the water rates are included in Section III of this report.

III. Water Rates

This section of the report describes proposed water rates for the combined water system. A three-year rate plan is presented. This section also includes information on the current water rates, customer account and water use data, the proposed Blacklake equity surcharge, proposed rate structure changes and alternatives considered, and the impact of proposed rates on typical water bills.

Current Water Rates

Exhibit III-1 summarizes the current water rates of both the District's Town and Blacklake Divisions. Water rates include a fixed bi-monthly service charge based on the size of the water meter. Single family residential customers are subject to a two-tier commodity rate structure, while other customer classes are subject to a uniform commodity rate. In addition, the District maintains a litigation charge applicable to all water customers to help defray the costs of litigation regarding the adjudication of the groundwater basin. Current water rates became effective in January 2007.

Exhibit III-1
Nipomo Community Services District
Current (2007) Water Rates

	Town Division	Blacklake Division	Litigation Charge (2)
Bi-Monthly Service Charges			
Up to 1"	$ 20.64	$ 22.08	$ 6.32
1 1/2"	$ 58.60	$ 61.09	$ 14.36
2"	$ 92.81	$ 96.24	$ 19.92
3"	$ 172.68	$ 178.33	$ 27.92
4"	$ 286.77	$ 295.58	$ 36.00
6"	$ 571.73	$ 588.42	$ 59.58
8"	$ 913.83	$ 939.98	$ 68.08
Water Usage Rates ($/HCF)			
Single Family Residential			
Tier 1 (0-40 HCF)	$ 1.38	$ 1.42	
Tier 2 (>40 HCF)	$ 2.35	$ 2.49	
Non-Residential (3)			
All Usage	$ 1.74	$ 1.73	

Notes:
(1) Effective January 1, 2007 as adopted with Ordinance 2005-103.
(2) Applies to all water connections in both the Town and Blacklake Divisions.
(3) Includes multi-family, commercial, irrigation, agricultural, industrial, and construction

Average bi-monthly water use for single family customers is 46 HCF[2] and median usage is 34 HCF. A typical water bill (with median usage) for single family customer within the Town with a meter size 1" or less is currently $73.88, including the litigation charge. A single family customer using the same amount of water in Blacklake would pay $76.68 under current water rates.

Current Customer Accounts and Water Use Data

The District currently provides water service to about 4,000 customers. **Exhibit III-2** summarizes the current number of customer accounts by meter size for each of the divisions. The Town Division includes about 3,400 customers and the Blacklake Division includes about 600 customers.

Exhibit III-2
Nipomo Community Services District
Summary of Combined Water System Accounts

	5/8"	3/4"	1"	1 1/2"	2"	3"	4"	Total
Combined Water System								
Single Family	2,341	13	1,090	1	3	-	-	3,448
Multi-Family	240	1	147	-	-	1	2	391
Commercial	32	2	32	13	10	1	-	90
Irrigation	4	-	51	19	7	1	-	82
Agricultural	-	1	-	-	1	-	-	2
Outside	1	3	-	-	-	-	-	4
Total	2,618	20	1,320	33	21	3	2	4,017
Equiv. Mtrs.	2,618	20	1,320	99	101	27	30	4,215
Hydr. Cap. Factor	1.0	1.0	1.0	3.0	4.8	9.0	15.0	

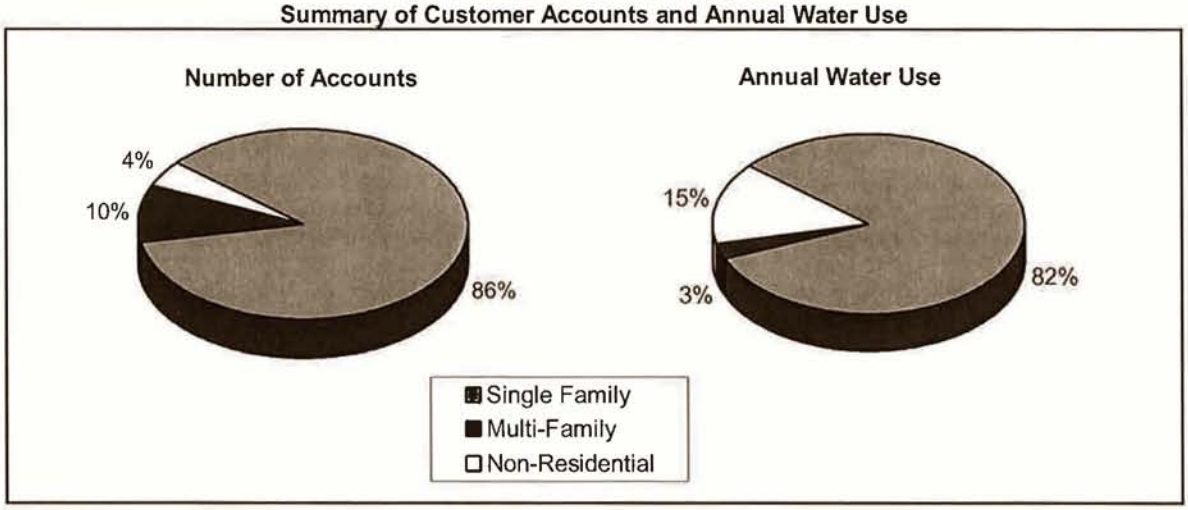
Exhibit III-3 graphically summarizes the number of customer accounts and annual water use by customer class.

Critical to the analysis of any tiered rate structure is the analysis of water use characteristics. The amount of revenue generated from each tier is related to each customer's bi-monthly water usage. Therefore, tier rate analysis required obtaining detailed water use information for each customer account.

The District's current water rates include tiers for single family residential customers because this customer class exhibits fairly homogeneous water use characteristics. Other customer classes exhibit diverse water use patterns and tiered rate structures are less effective as a conservation tool in such cases. Tiered rates can be developed for multi-family residential customers on a per-dwelling-unit basis, and a growing number of utilities are using water budget-based tier structures for irrigation accounts. Water budget-based rates, however, require determining a water budget based on irrigated area, evapotranspiration data, and potentially plant types. The additional administrative complexity of such structures must be weighed with other considerations when considering tier structures for non-single family customer classes.

[2] 1 HCF = 100 cubic feet = 748 gallons.

Exhibit III-3
Nipomo Community Services District
Summary of Customer Accounts and Annual Water Use



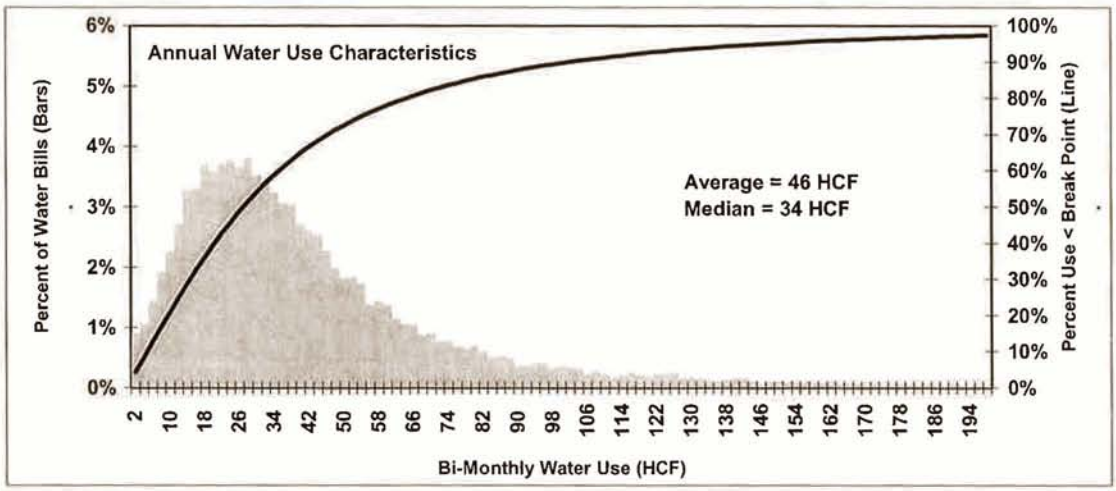
Single family water use varies throughout the year based on seasonal irrigation demands. Water use also varies for other reasons as well including number of people per household, landscape characteristics, parcel size, personal habits, and other factors. Even with this variation, single family water usage characteristics are more homogeneous than other customer classes.

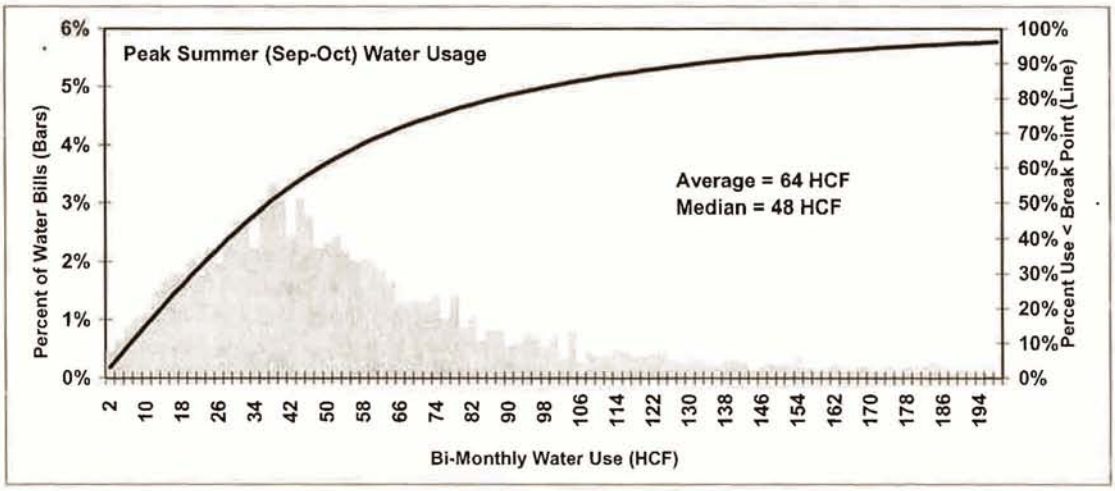
Exhibit III-4 provides water use frequency distributions for single family customers in the combined water system. Individual graphs summarize bi-monthly water use on an annual basis, during the peak summer billing period (September-October) and during the low use winter billing period (January-February). Average and median use is shown for each graph. The bell-shaped shaded region of each graph provides a histogram showing the number of customer bills with various levels of water usage. The curved line indicates the percentage of water use below a specified level of use. The line in the top (annual) graph is critical to tier rate design in that it indicates that amount of water that would be sold within any tier once tier break points are established. This information is used later in this section in the development of the proposed tiered water rates for single family customers.

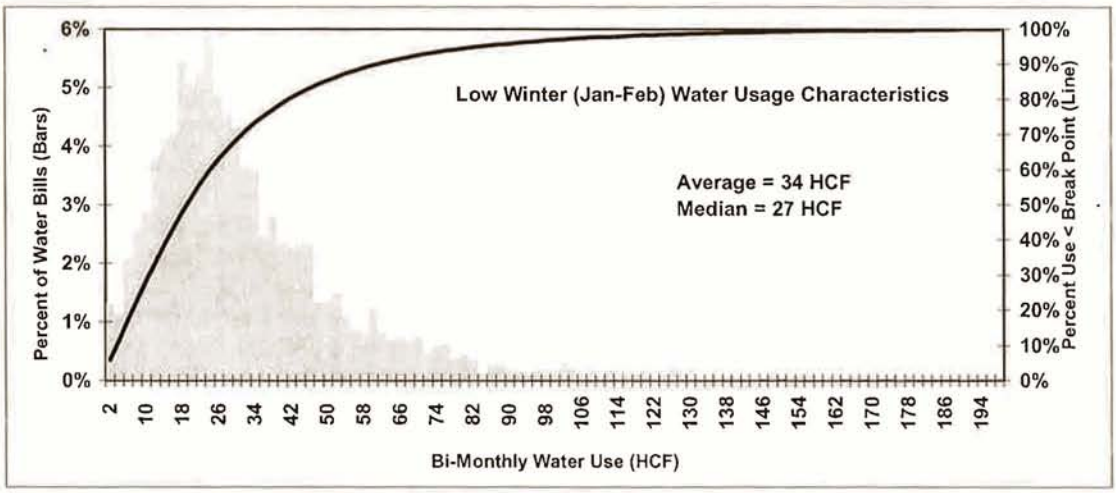
Blacklake Equity Surcharge

As the District is considering the merger of the water systems for the Town and Blacklake Division, one unresolved issue is the relative difference in the investment made into the respective water systems by existing customers of the two systems. Customers of each system have contributed to the construction and investments made into each water system, but the relative investments in each system vary. This study included evaluating the value of water system assets within each water system, as well as financial reserves, as reflected in audited financial statements and expressing this information on a per-account basis. The difference in the value of water system assets and financial resources between the two water systems would be the basis for an equity surcharge to be paid by the customers than have made a lesser relative investment.

Exhibit III-4
Nipomo Community Services District
Water Use Characteristics for Single Family Residential Customers







Financial information used in preparing the District's audited financial statements ending June 30, 2006 was used for the equity analysis. **Exhibit III-5** presents asset and financial resource information and the resulting calculation of a proposed equity surcharge.

Exhibit III-5
Nipomo Community Services District
Summary of Water System Assets and Financial Reserves as of June 30, 2006

		Town Division				Blacklake Division		
		Water Operating Town (Fund 120)	Water Capacity (Fund 700)	Funded Depreciation Town Water (Fund 800)	Town Division Totals	Water Operating Blacklake (Fund 140)	Funded Depreciation Blacklake Water (Fund 820)	Blacklake Division Totals
Water System Assets								
1520	Water - Pumping	$ 1,598,264	$ 774,742	$ 192,373	$ 2,565,379	$ 1,576,268	$ 39,670	$ 1,615,938
1525	Water - Transmission	$ 1,157,964	$ 1,238,291		$ 2,396,255			$ -
1530	Water - Distribution	$ 475,714	$ 79,365	$ 116,603	$ 671,682	$ 68,047	$ 2,749	$ 70,796
1535	Water - Contributed	$ 6,147,216			$ 6,147,216	$ 505,732		$ 505,732
1540	Buildings	$ 55,188			$ 55,188			$ -
1545	Machinery & Equipment	$ 82,129		$ 126,822	$ 208,951	$ 9,800	$ 30,645	$ 40,445
1550	Computer Equipment	$ 65,759			$ 65,759	$ 7,442		$ 7,442
1555	Office Furniture & Fixtures	$ 9,310			$ 9,310			$ -
1560	Land and Land Rights	$ 43,500	$ 235,739		$ 279,239			$ -
1570	Vehicles	$ 102,507			$ 102,507	$ 15,667		$ 15,667
1590	Work in Progress		$ 30,125		$ 30,125		$ 13,593	$ 13,593
1595	Accumlated Depreciation	$ (4,396,254)	$ (371,827)	$ (33,851)	$ (4,801,932)	$ (1,103,130)	$ (4,104)	$ (1,107,234)
Book Value of Water System Assets		$ 5,341,297	$ 1,986,435	$ 401,947	$ 7,729,679	$ 1,079,826	$ 82,553	$ 1,162,379
Financial Reserves								
1099	Cash Balance	$ 899,909	$ 4,654,295	$ 1,776,215	$ 7,330,419	$ (25,287)	$ 491,609	$ 466,322
1210	A/R - Utility Billing	$ 36,852			$ 36,852	$ 30,479		$ 30,479
1220	Unbilled A/R - Utility Billing	$ 331,000			$ 331,000	$ 29,000		$ 29,000
1240	Receivable - Other	$ 9,902			$ 9,902			$ -
2135	Accrued Interest Receivable	$ 10,750	$ 51,732	$ 19,919	$ 82,401	$ 90	$ 5,514	$ 5,604
2100	Accounts Payable	$ (47,143)	$ (4,594)		$ (51,737)	$ (11,333)	$ (2,160)	$ (13,493)
2110	Refunds Payable - MQ	$ (939)			$ (939)			$ -
2120	Construction Meter Deposits	$ (11,500)			$ (11,500)			$ -
2130	Compensated Absences Payable	$ (23,005)			$ (23,005)	$ (2,397)		$ (2,397)
2320	Accrued Wages	$ (4,352)			$ (4,352)	$ (968)		$ (968)
2450	Deposit - Pomeroy Water Line				$ -	$ (24,170)		$ (24,170)
2510	Revenue Bonds - Current Portion	$ (9,000)			$ (9,000)			$ -
2610	Revenue Bonds Payable	$ (129,000)			$ (129,000)			$ -
Financial Reserves		$ 1,063,474	$ 4,701,433	$ 1,796,134	$ 7,561,041	$ (4,586)	$ 494,963	$ 490,377
Total of Assets and Reserves		$ 6,404,771	$ 6,687,868	$ 2,198,081	$ 15,290,720	$ 1,075,240	$ 577,516	$ 1,652,756
No. of Equivalent Meters					3,579			636
Water System Assets per Equivalent Meter					$ 2,160			$ 1,829
Financial Reserves per Equivalent Meter					$ 2,112			$ 772
Total Assets and Reserves per Equivalent Meter					$ 4,272			$ 2,600

	Alternative Bi-Monthly Payments Over:					
	Lump Sum	1 Year	2 Years	5 Years	10 Years	Interest
Blacklake Equity Surcharge ($/ Eq. Mtr.)	$ 1,672	$ 286.82	$ 146.98	$ 63.21	$ 35.52	5.0%
Annual Revenue from Each Alternative	$ 1,062,594	$ 1,093,801	$ 560,514	$ 241,069	$ 135,462	

The book value (original cost less accumulated depreciation) of water system assets of the Town Division totals about $7.73 million. The book value of water system assets of the Blacklake Division totals about $1.16 million. Cash reserves, adjusted for short term receivables, short term payables, deposits, and outstanding long-term debt, for the Town Division totals about $7.56 million. Adjusted cash reserves for the Blacklake Division totals about $490,000.

The denominator used to determine the equity surcharge is the number of 1" equivalent meters. This is similar to the number of accounts, but reflects the relative capacities of different meter sizes.

The Town Division has 3,579 equivalent meters and the Blacklake Division has 636 equivalent meters.

The relative investment in water system assets and financial resources of customers in the Town and Blacklake Divisions is $4,272 and $2,600 per 1" equivalent meter, respectively. The difference between these two amounts is $1,672 and represents the amount that customers of Blacklake should make to establish equity and parity in a combined water system.

Conceivably the equity surcharge could be paid by Blacklake water system customers in a single lump sum payment. However, alternative payment approaches are possible, which would allow the surcharge to be paid over time. At the request of the District, bi-monthly payments that would last for one, two, five, or ten years were developed for the Board of Director's consideration. Bi-monthly payment alternatives all assume a 5.0 percent interest rate.

If paid entirely in a lump sum, the Blacklake equity surcharge would provide about $1.06 million for the combined water system. The District could potentially allow each customer to elect whether to pay the lump sum amount or one or more of the bi-monthly surcharge approaches. For purposes of preparing the financial plan included in Section II of this report, it was assumed that the equity surcharge would be paid over ten years by all Blacklake customers. This is the most financially conservative assumption for planning purposes. Any other payment approach would result in the District receiving equity surcharge revenues sooner. The bi-monthly equity surcharge paid over a ten year period would be $35.52 for water meters up to 1". A complete equity surcharge schedule for different meter sizes and payment periods is included in Exhibit I-1, in the Executive Summary of this report.

Water Rate Calculations

The calculation of water rates involves a three-step process. First, the annual water rate revenue requirement must be determined. The water rate revenue requirement is that amount of revenues to be generated annually to meet operating and capital program needs with consideration of other water system revenues and reserves. Annual water rate revenue requirements were determined using the five-year financial plan model described in the previous section. The second step in the rate setting process is a cost of service analysis accomplished by the allocation of water system costs to rate components. Finally, the third step in the process is rate design and the development of water rate schedules.

Annual Water Rate Revenue Requirement

The annual water rate revenue requirements were determined for each fiscal year of the planning period using the five-year financial planning model. Because the District adjusts water rates at the beginning of each calendar year, fiscal year revenue requirements are converted into calendar year revenue requirements. The District requested that specific rate schedules be developed for the next three years (not the entire five-year planning period). Estimated current calendar year water rate revenues as well as future water rate requirements for the next three years are summarized below. The percentage change in the rate revenue requirement differs from the percentage change in overall level of rates due to the merger of the two divisions and rates (in 2008), growth in the customer base, and estimated increased water conservation.

	Water System Rate Rev. Reqmt.	Percent Change
2007	$2,656,000	
2008	$2,954,000	11.2%
2009	$3,310,000	12.1%
2010	$3,711,000	12.1%

Current water rates differ for the Town and Blacklake Divisions, but this study assumes they will be consolidated in 2008. The water rate schedules developed for each of the next three years are intended to generate the amount of revenue listed above. Annual rate calculations also reflect assumptions for new development and increased water conservation, both of which have an impact on rate revenues separate from the rate structures themselves.

Cost of Service Analysis

Cost allocation is the method by which the annual water rate revenue requirement is recovered from each customer class based on the cost of providing water service. The cost allocation process is shown schematically in **Exhibit III-6**. There are a number of ways to allocate costs for rate setting purposes. Some are rather complex and require detailed knowledge of water system costs, cost drivers, and customer water use characteristics (including peaking characteristics). Others are somewhat simpler to understand and administer. The approach used herein is commensurate with available data that categorizes water system costs into three specific categories. These include:

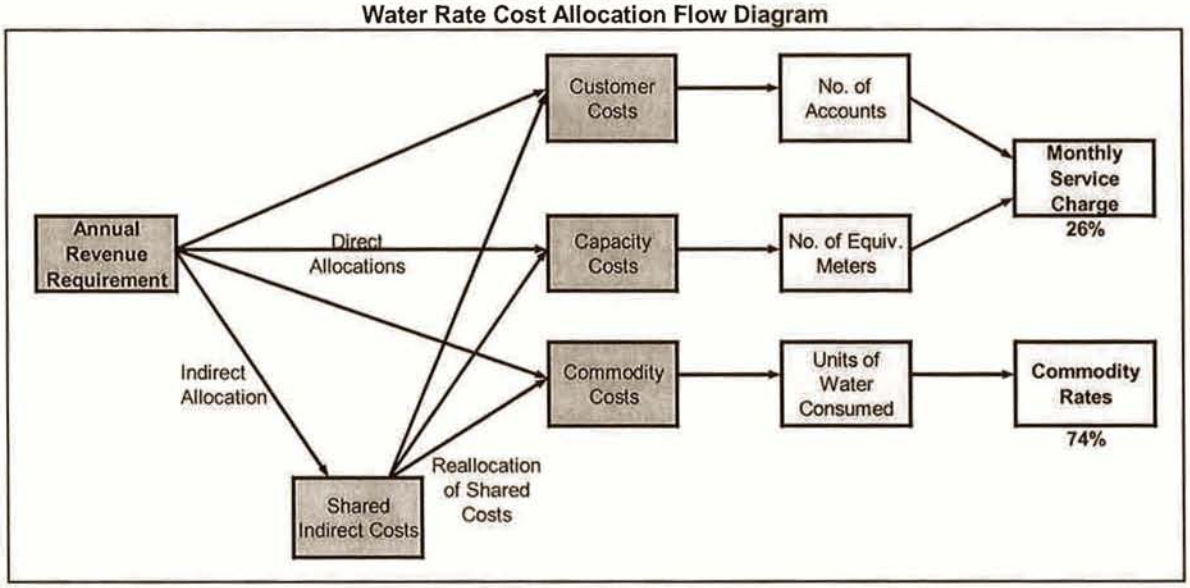
- *Customer Costs* – Customer costs such as meter reading, billing, and customer service are fixed costs that tend to vary as the function of the number of customers served. Customer costs are allocated equally to all customers based on the total number of accounts, and are included in the bi-monthly service charge.

- *Capacity Costs* – Capacity costs are also fixed costs. However, they tend to vary in relation to the capacity of the water system. Customers that can place greater or lesser demands on the water system should bear greater or lesser shares of these costs. The water system is sized to meet peak demands. The demand that each customer could potentially place on the water system is reflected in the size and capacity of the water meter. Capacity costs include fixed operating costs, water system maintenance, and debt service. Capacity costs are allocated to each customer based on the size and capacity of the water meter, and are included in the bi-monthly service charge calculation.

- *Commodity Costs* – Commodity costs include those costs that vary with the amount of actual water usage. Water treatment and pumping costs are the most significant examples. In addition, other costs that may not be truly variable are often allocated based on water usage because allocating these costs to each customer based on water usage is an equitable basis. Commodity costs are used to determine the commodity rates of the rate structure. Many utilities also place what may be considered fixed costs into the variable commodity component as a means of encouraging water conservation. It is fairly typical for commodity rates to account for 65 to 90 percent of water rate revenues, even when a majority of costs might be considered fixed.

- *Shared (Indirect) Costs* – Some cost items are not directly allocated to any of the three components identified above. Instead these costs are first allocated as shared (indirect) costs, and subsequently reallocated to each of the three components based on the percentage of costs that were directly allocated to these components.

Exhibit III-6
Nipomo Community Services District
Water Rate Cost Allocation Flow Diagram



The allocation of costs to each of the cost components occurs at the individual line-item level of detail in the District's budget and account structure. Most costs are allocated directly to the customer, capacity, or commodity components, although some are categorized as shared costs then reallocated indirectly. As shown in Exhibit III-6, the cost allocation results in about 26 percent of costs to be recovered from service charges and 74 percent to commodity rates. This is about the same as the current rate structures.

Water Rate Structure Design

Water rate design and the development of rate schedules take place after the annual water rate revenue requirement is determined and after the cost of service analysis has been performed. Based on discussions with District staff, the District seeks to increase the water conservation incentives embodied in the rate structure. After discussing a variety of alternatives, it is recommended that the District increase the number of tiers in the single family rate structure from two to four. In addition, the tier break points, and the tier steps should be refined to help improve the conservation effectiveness of the tier structure.

Proposed water rates include both service charges and commodity rates, as well as continuation of the litigation charge. Each of these are described below.

Service Charges

Exhibit III-7 presents the bi-monthly service charge calculations for the combined water system for 2008. The service charges recover customer and capacity costs from each customer. Customer costs are allocated equally to all customers, and capacity costs are allocated based on the hydraulic capacity associated with each meter size.

Exhibit III-7
Nipomo Community Services District
Calculation of Water Service Charges for the Town Division

	Meter Size							
	1" or Less	1 1/2"	2"	3"	4"	6"	8"	Total
Customer Accounts								
No. of Customers	3,958	33	21	3	2	-	-	4,017
No. of Equivalent Meters	3,958	99	101	27	30	-	-	4,215
Hydraulic Capacity Factor (1)	1.0	3.0	4.8	9.0	15.0	30.0	48.0	
Bi-Monthly Service Charges								
Customer Cost	$ 1.79	$ 1.79	$ 1.79	$ 1.79	$ 1.79	$ 1.79	$ 1.79	
Capacity Cost	$ 22.79	$ 68.36	$ 109.38	$ 205.09	$ 341.82	$ 683.57	$ 1,093.75	
Total Service Charges	**$ 24.57**	**$ 70.15**	**$ 111.17**	**$ 206.88**	**$ 343.60**	**$ 685.36**	**$ 1,095.54**	
Litigation Charge (2)	$ 6.32	$ 14.36	$ 19.92	$ 27.92	$ 36.00	$ 59.58	$ 68.08	
Combined Service Charges	$ 30.89	$ 84.51	$ 131.09	$ 234.80	$ 379.60	$ 744.94	$ 1,163.62	
Annual Service Charge Revenue								
Single Family	$ 638,376	$ 507	$ 2,360	$ -	$ -	$ -	$ -	$ 641,242
Multi-Family	$ 71,919	$ -	$ -	$ 1,409	$ 4,555	$ -	$ -	$ 77,883
Non-Residential	$ 23,355	$ 16,226	$ 14,157	$ 2,818	$ -	$ -	$ -	$ 56,556
Total Srv. Chrg. Revenue	$ 733,650	$ 16,733	$ 16,517	$ 4,226	$ 4,555	$ -	$ -	$ 775,682

Water Rate Revenue Requirement			
Customer Costs	$	43,026	1.5%
Capacity Costs	$	576,281	19.5%
Commodity Costs (3)	$	2,178,318	73.7%
Litigation Charge	$	156,375	5.3%
Total Revenue Requirement	**$**	**2,954,000**	

Notes:
(1) See text of report for discussion of capacity factors.
(2) Litigation charges remain unchanged.
(3) Commodity costs recovered through commodity rates. See Exhibit III-8.

Each meter type and size has a rated maximum flow capacity. Hydraulic capacity factors are determined by taking the ratio of the rated capacity for each meter size to that of the standard meter size (typically a ¾" or 1" meter). Because the District treats all meters up to 1" as equivalent, the standard rated capacity was determined by calculating the weighted average capacity of all existing meters up to 1" in size. This resulted in a standard rating of 33 gpm. Capacity factors for meters larger than 1" were determined by taking the ratio of each meter size's rated capacity to the standard of 33 gpm. For example, the capacity factor of a 1 ½" meter is 3.0 (100 gpm / 33 gpm).

The District's litigation charge associated with groundwater management issues is proposed to be continued, without change, until resolution of those issues. The litigation charge is also shown in Exhibit III-7. The charge is expected to remain through the planning period as certain legal and groundwater monitoring costs are expected to continue. However, the Board of Directors has indicated that the charge will be removed when the litigation issues are resolved and associated costs end.

Commodity Rates

Exhibit III-8 presents the commodity rate calculations for the combined water system for 2008. A uniform commodity rate is proposed for multi-family and non-residential customers and is consistent with the current rate structure for these customer classes. The uniform commodity rate is determined by dividing the total commodity costs resulting from the cost of service analysis by the total annual water sales of the District. In this case, costs of about $2,178,300 are spread over about 1,137,600 HCF to arrive at a uniform rate of $1.91 per HCF

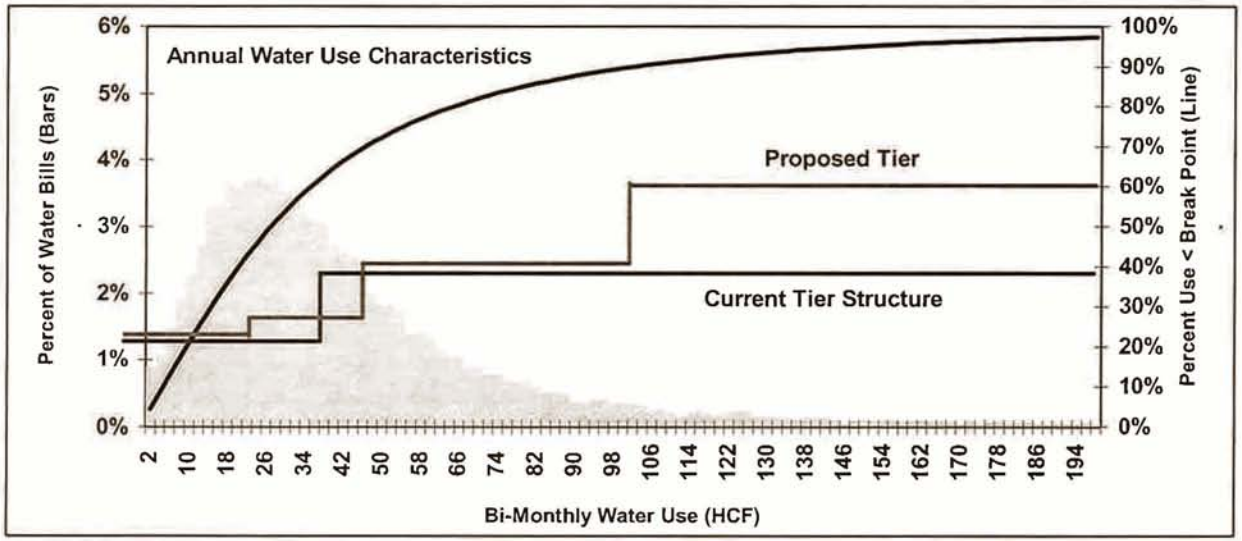
The proposed tier structure is shown graphically in **Exhibit III-9**, along with the current structure for comparative purposes. The annual water use profile is also included as an indicator of the number of customer bills occurring in each tier. The rationale behind the proposed tier design is described below.

Exhibit III-8
Nipomo Community Services District
Calculation of Water Commodity Rates for the Town Division

No. of Accts.	Customer Class	Ann. Water Use (HCF)	FIRST TIER Rate ($/HCF)	FIRST TIER Revenue	Break Point	SECOND TIER Rate ($/HCF)	SECOND TIER Revenue	Break Point	THIRD TIER Rate ($/HCF)	THIRD TIER Revenue	Break Point	FOURTH TIER Rate ($/HCF)	FOURTH TIER Revenue	Annual Revenue
3,448	Single Family	939,041	$ 1.44	$ 660,987	27	$ 1.66	$ 349,234	48	$ 2.49	$ 448,677	104	$ 3.74	$ 339,224	$ 1,798,121
	% of Water Use -->			48.7%			22.4%			19.2%			9.7%	
	% of Water Bills -->			37.3%			32.2%			23.4%			7.1%	
391	Multi-Family	32,088	$ 1.91	$ 61,444										$ 61,444
178	Non-Residential	166,464	$ 1.91	$ 318,753										$ 318,753
4,017	**TOTALS**	**1,137,593**												**$ 2,178,318**

Summary of Commodity Costs
Total Commodity Costs **$ 2,178,318** (from Exhibit III-7)

Exhibit III-9
Nipomo Community Services District
Current and Proposed Single Family Tier Structures



The development of the single family tier structure requires additional analysis. However, the weighted average commodity rate from the proposed tier structure is calculated to also equal $1.91 per HCF. With this as a constraint in the determination of the tiered water rates, the proposed rates are equitable relative to the uniform rate for the other customer classes.

Winter water use is generally representative of indoor water needs, as most customers will turn off irrigation systems during wet winter months. However, analysis of single family water use during January-February indicates that average single family water use is 34 HCF (about 417 gpd). Indoor single family water usage is typically in the 200 to 300 gpd range. While it is difficult to predict what factors are causing the high water usage during winter months, efforts to remind customers to turn off or cut back irrigation systems during the winter may prove beneficial in the District's water conservation efforts.

Summer water use is typically more dominated by irrigation. As shown in Exhibit III-4, average peak summer use is nearly twice the winter average use. The seasonal fluctuation is irrigation demands is illustrated by the change in the shape and size of the bell-shaped water use histograms shown in the graphs in Exhibit III-4.

While there is an infinite number of possible tier allocation and rate combinations that could satisfy the overall revenue requirement for the single family commodity rates, the proposed 4-tier water rate structure has been designed around the specific water use characteristics for single family customers within the District. The intent is to allow reasonable water use for non-discretionary domestic purposes at the lowest rate, a basic allocation of water for discretionary (primarily irrigation) purposes, and higher rates for water usage that exceeds typical usage even during the peak summer period. Tier break points are proposed to be established as follows.

- First tier — 0 to 27 HCF — Median winter water use is 27 HCF (or 330 gpd). The first tier is designed such that 50 percent of single family customers will be in the first tier during the winter without any changes to water use. However, because the median water use appears high, the proposed tier structure should encourage customers to reduce winter usage (by reducing winter irrigation) so it is reasonable to expect that a majority of customers could be within the first tier during winter months.
- Second tier — 28 to 48 HCF — Median use during the peak summer period is 48 HCF (or 590 gpd). The second tier is intended for basic irrigation water demands, and should be sufficient for a majority of customers in all but the peak of the irrigation season.
- Third tier — 49 to 104 HCF — The 85th percentile of peak summer use is 104 HCF (or 1,275 gpd). This water usage extends beyond the typical water use range during the summer season and is therefore the target of increased financial incentive to reduce water usage.

➢ Fourth tier	Over 104 HCF	Only 15 percent of single family customers use more than 104 HCF during the peak summer demand period. Therefore this fourth tier is intended to target this highest water use range with the purpose of encouraging water conservation. Customers in this highest tier will benefit the most from reducing their water usage.

Tier rate design must also consider the rates applicable to each tier. In effect, the tier rate design is a zero sum game. That is, with the constraint that the average commodity rate across the single family class should be $1.91 per HCF, reducing the rate in one place means that it must be higher somewhere else.

To provide an increasing incentive to use water efficiently the tier steps are proposed to increase in magnitude with each tier step. As shown in Exhibit III-8, the proposed rates include a modest step increase (15 percent) between the first and second tier. This is because the second tier represent normal and reasonable irrigation water usage, and the tier structure should not be perceived as punitive in this use range. The first two tiers should be viewed (and explained) as normal usage ranges for indoor domestic purposes (first tier) and reasonable irrigation (second tier). Tier steps to the third and fourth tiers are more dramatic (50 percent increase with each tier). This is intended to provide a stronger financial incentive for customers to reduce water use in these higher use ranges.

Two additional factors were considered in the development of the proposed tier structure. First, all customers will benefit from the lower rate of the first tier, including customers that are in the upper tiers. In fact, nearly one-half of the single family water sales will be at the first tier rate. Second, while supplemental water costs are not yet included in the costs of the District's operations or in the water rates, the cost of supplemental water can be used to encourage customers to efficiently use water. In effect, the supplemental water costs represent the marginal cost of water supply for the District's customers. The highest tier rate in the proposed structure is less than the rate that may be necessary when supplemental water begins to be delivered to the service area, but it can help encourage customers to change water use patterns in advance of supplemental water becoming a reality.

Proposed Water Rates Schedules

Exhibit III-10 presents the proposed water rate schedules for the combined water system for 2008 through 2010. The proposed rates are intended to meet the annual revenue needs of each water utility, as estimated in the financial plans described in Section II. The change to the single family tier structure occurs in 2008, and all rate components increase by an equal percentage in each of the two subsequent years.

Exhibit III-10
Nipomo Community Services District
Current and Proposed Water Rates

	Current Rates (1)		Proposed Combined Water Rates			Litigation
	Town	Blacklake	Jan. 2008	Jan. 2009	Jan. 2010	Charge (2)
Bi-Monthly Service Charges						
Up to 1"	$ 20.64	$ 22.08	$ 24.57	$ 27.52	$ 30.82	$ 6.32
1 1/2"	$ 58.60	$ 61.09	$ 70.15	$ 78.57	$ 88.00	$ 14.36
2"	$ 92.81	$ 96.24	$ 111.17	$ 124.51	$ 139.45	$ 19.92
3"	$ 172.68	$ 178.33	$ 206.88	$ 231.71	$ 259.52	$ 27.92
4"	$ 286.77	$ 295.58	$ 343.60	$ 384.83	$ 431.01	$ 36.00
6"	$ 571.73	$ 588.42	$ 685.36	$ 767.60	$ 859.71	$ 59.58
8"	$ 913.83	$ 939.98	$ 1,095.54	$ 1,227.00	$ 1,374.24	$ 68.08
Water Usage Rates ($/HCF)						
Single Family Residential						
Tier 1 (0-27 HCF)	$ 1.38	$ 1.42	$ 1.44	$ 1.61	$ 1.80	
Tier 2 (28-48 HCF)	$ 2.35	$ 2.49	$ 1.66	$ 1.86	$ 2.08	
Tier 3 (49-104 HCF)	(3)	(3)	$ 2.49	$ 2.79	$ 3.12	
Tier 4 (>104 HCF)			$ 3.74	$ 4.19	$ 4.69	
Non-Residential (4)						
All Usage	$ 1.74	$ 1.73	$ 1.91	$ 2.14	$ 2.40	

Notes:
(1) Effective January 1, 2007 as adopted with Ordinance 2005-103.
(2) No changes are proposed for the litigation charge, which applies to all water connections until resolution of groundwater litigati
(3) Under the current rates, the Tier 1 rate applies to the first 40 HCF and the Tier 2 rate applies to use in excess of 40 HCF.
(4) Includes multi-family, commercial, irrigation, agricultural, industrial, and construction.

Appendix A – Financial Plan Exhibits

The following exhibit summarizes the combined water system five-year financial plan developed for the District and described in Section II of this report.

Appendix A
Nipomo Community Services District
Combined Water Divisions Financial Plan

	FY 05-06 Actual	FY 06-07 Estimate	FY 07-08 Budget	FY 08-09	FY 09-10	FY 10-11	FY 11-12
Proposed CY Rate Increases -->			12%	12%	12%	12%	12%
OPERATING FUND (FUNDS 120 & 140)							
Beginning Balance	162,967	778,298	1,574,000	1,649,982	1,967,682	2,474,544	2,665,548
Revenues							
Water Availability Charges	566,648	620,000	714,000	786,000	870,000	965,000	1,072,000
Water Usage Charges	1,619,511	1,955,000	2,068,000	2,319,000	2,610,000	2,937,000	3,306,000
Fees and Penalties	49,703	40,000	42,200	42,600	43,000	43,400	43,800
Meter & Connection Fees	10,905	5,300	6,875	6,900	7,000	7,100	7,200
Plan Check & Insp. Fees	100	-	-	-	-	-	-
Miscellaneous Income	39,793	25,000	25,000	25,300	25,600	25,900	26,200
Interest Earnings	31,630	61,200	78,300	74,200	88,500	111,400	119,900
Transfer from Suppl. Wtr. Fund			-	-	240,000	285,143	577,918
Total Revenues	2,318,290	2,706,500	2,934,375	3,254,000	3,884,100	4,374,943	5,153,018
Expenditures							
Operations & Maintenance							
Wages	169,710	169,500	222,500	302,700	311,800	321,200	330,800
Wages - Overtime	30,130	34,500	36,025	37,100	38,200	39,300	40,500
Payroll Taxes	4,528	5,250	4,720	4,900	5,000	5,200	5,400
Retirement	48,504	41,600	60,300	62,100	64,000	65,900	67,900
Medical and Dental	38,996	40,800	60,345	62,200	64,100	66,000	68,000
Workers Comp Insur.	15,681	13,400	15,000	15,500	16,000	16,500	17,000
Electricity - Pumping	264,294	390,000	410,000	426,500	443,700	372,000	294,000
Natural Gas - Pumping	65,252	117,000	135,000	140,400	146,100	152,000	158,100
Supplemental Water	-	-	-	-	-	796,000	2,000,000
Chemicals	2,908	5,150	16,000	16,600	17,300	18,000	18,700
Lab Tests and Sampling	20,203	20,200	31,000	32,200	33,500	34,900	36,300
Operating Supplies	44,062	46,000	56,000	58,300	60,600	63,000	65,500
Outside Services	39,208	52,000	70,000	72,100	74,300	76,500	78,800
Permits & Operating Fees	5,083	8,600	9,820	10,100	10,400	10,700	11,000
Repairs & Maintenance	103,791	140,000	150,000	154,500	159,100	163,900	168,800
Repairs & Maint - Vehicles	12,594	8,100	12,600	13,000	13,400	13,800	14,200
Engineering	9,614	-	10,500	10,800	11,100	11,400	11,700
Fuel	15,582	19,760	24,480	25,500	26,500	27,600	28,700
Paging and Cellular Service	3,512	3,400	4,215	4,300	4,400	4,500	4,600
Meters - New Installations	7,549	6,000	15,000	15,500	16,000	16,500	17,000
Meters - Replac. Program	5,302	18,000	22,000	22,700	23,400	24,100	24,800
Uniforms	2,630	3,800	4,490	4,600	4,700	4,800	4,900
Wtr Conserv/Recycl Prog.	2,234	7,500	53,700	55,300	57,000	58,700	60,500
Oper. Transfer Out - Replac.	93,678	88,000	392,000	403,800	415,900	428,400	441,300
Total Oper. & Maint.	1,005,045	1,238,560	1,815,695	1,950,700	2,016,500	2,790,900	3,968,500
General & Administrative							
Wages	94,509	87,700	190,425	196,100	202,000	208,100	214,300
Payroll Taxes	1,864	1,900	3,390	3,500	3,600	3,700	3,800
Retirement	25,828	23,800	53,000	54,600	56,200	57,900	59,600
Medical and Dental	19,355	20,100	38,490	39,600	40,800	42,000	43,300
Workers Comp Insur.	922	900	1,735	1,800	1,900	2,000	2,100

Appendix A -- Continued
Nipomo Community Services District
Combined Water Divisions Financial Plan

	FY 05-06 Actual	FY 06-07 Estimate	FY 07-08 Budget	FY 08-09	FY 09-10	FY 10-11	FY 11-12
Audit	-	2,412	4,560	4,700	4,800	4,900	5,000
Bank Charges & Fees	429	500	660	700	700	700	700
Computer Expense	18,625	11,400	18,240	18,800	19,400	20,000	20,600
Director Fees	8,721	10,820	13,680	14,100	14,500	14,900	15,300
Dues & Subscriptions	3,854	6,000	5,530	5,700	5,900	6,100	6,300
Education & Training	1,692	1,800	3,135	3,200	3,300	3,400	3,500
Elections	-	2,378	-	2,500	-	2,500	-
Insurance - Liability	17,293	18,200	19,095	19,700	20,300	20,900	21,500
Landscape and Janitorial	4,977	5,200	5,550	5,700	5,900	6,100	6,300
Legal - Gen. & Spec. Counsel	42,194	76,200	100,000	103,000	106,100	109,300	112,600
Legal - Water Counsel	267,312	135,000	100,000	103,000	106,100	109,300	112,600
Professional Services	-	49,000	111,040	114,400	117,800	121,300	124,900
Miscellaneous	10	1,500	2,000	2,100	2,200	2,300	2,400
Newsletter and Mailers	-	-	1,740	1,800	1,900	2,000	2,100
Office Supplies	7,098	10,600	8,265	8,500	8,800	9,100	9,400
Outside Services	3,380	2,150	5,510	5,700	5,900	6,100	6,300
Postage	9,338	9,000	15,070	15,700	16,300	17,000	17,700
Public Notices	489	-	3,400	3,500	3,600	3,700	3,800
Repairs & Maint. - Office Equip	958	800	2,280	2,300	2,400	2,500	2,600
Property Taxes	663	815	830	900	900	900	900
Telephone	2,411	2,900	2,985	3,100	3,200	3,300	3,400
Travel & Mileage	3,824	5,100	5,700	5,900	6,100	6,300	6,500
Oper. Transfer Out - Admin.	129,371	152,483	178,299	183,600	189,100	194,800	200,600
Total Gen'l & Admin.	665,117	638,658	894,609	924,200	949,700	981,100	1,008,100
Other Expenditures							
Wtr Rev Bond DS - Interest	7,300	6,900	6,775	6,000	5,500	5,000	4,500
Wtr Rev Bond DS - Principal	9,000	9,000	9,000	10,000	10,000	10,000	11,000
COP Debt Service - Interest					240,000	233,476	226,560
COP Debt Service - Principal					108,738	115,263	122,178
Fixed Asset Purchases	16,497	17,680	132,314	45,400	46,800	48,200	49,600
Total Other Expenditures	32,797	33,580	148,089	61,400	411,038	411,938	413,838
Total Expenditures	1,702,959	1,910,798	2,858,393	2,936,300	3,377,238	4,183,938	5,390,438
Ending Balance	**778,298**	**1,574,000**	**1,649,982**	**1,967,682**	**2,474,544**	**2,665,548**	**2,428,129**
Oper. Resrv. (50% of Expend.)	788,000	895,000	1,159,000	1,236,000	1,275,000	1,672,000	2,268,000
Uncommitted Fund Balance	(9,702)	679,000	490,982	731,682	1,199,544	993,548	160,129
DS Coverage (Min. 1.15 w/ CCs) -->					7.04	4.87	2.94
DS Coverage (Min. 1.00 w/o CCs) -->					5.21	2.98	1.00
FUNDED REPLACEMENT - COMBINED WATER (FUNDS 800 & 820)							
Beginning Balance	2,256,277	2,259,000	2,361,000	2,263,500	362,200	887,400	1,448,700
Revenues and Transfers							
Interest Earnings	87,005	114,000	106,500	101,900	16,300	39,900	65,200
Blacklake Equity Surcharge	-	-	68,000	135,000	135,000	135,000	135,000
Operating Transfers In	93,678	88,000	392,000	403,800	415,900	428,400	441,300
Total Revs. and Trans.	180,683	202,000	566,500	640,700	567,200	603,300	641,500
Expenditures							
Previous Expenditures	177,960	100,000					
Fire Hydrant Replac.			50,000	-	-	-	-
Well Refurbishment			45,000	-	-	-	-
Quad Tank Coating & Maint.			75,000	-	-	-	-
BL Shop Construction			68,000	-	-	-	-
BL Bstr Sta Rebuild or Merge			112,000	-	-	-	-
BL Well #3 Casing Rehab.			20,000	-	-	-	-
GIS Upgrades			15,000	15,000	15,000	15,000	15,000
SCADA Upgrades			15,000	15,000	15,000	15,000	15,000
Reset Mains - Drainage			100,000				
Reset Mains - Roads			50,000	10,000	10,000	10,000	10,000
Security			100,000	-	-	-	50,000
Contingency (5%)			14,000	2,000	2,000	2,000	4,500
Trans. to Suppl. Wtr. Fund			-	2,500,000	-	-	-
Total Expenditures	177,960	100,000	664,000	2,542,000	42,000	42,000	94,500
Ending Balance	**2,259,000**	**2,361,000**	**2,263,500**	**362,200**	**887,400**	**1,448,700**	**1,995,700**

Appendix A -- Continued
Nipomo Community Services District
Combined Water Divisions Financial Plan

	FY 05-06 Actual	FY 06-07 Estimate	FY 07-08 Budget	FY 08-09	FY 09-10	FY 10-11	FY 11-12
SUPPLEMENTAL WATER FUND (FUND 500)							
Beginning Balance			2,300,000	1,774,836	11,333,613	238,357	-
Revenues and Transfers							
Suppl. Wtr. Capac. Charges			465,000	528,877	544,744	561,086	577,918
Interest Earnings			103,500	79,900	510,000	10,700	-
Trans. from Replac. Fund			-	2,500,000	-	-	-
Purveyor Contributions			-	5,000,000	-	-	-
Other Funding Source - TBD			-	3,500,000	-	-	-
Total Revs. and Trans.			568,500	11,608,777	1,054,744	571,786	577,918
Expenditures							
Suppl. Water Project Planning			1,093,664	2,050,000	910,000		
Suppl. Water Project Constr.			-	-	11,000,000	-	-
MOU Installment Payments			-	-	-	525,000	
Trans. for COP DS & Credit			-	-	240,000	285,143	577,918
Total Expenditures			1,093,664	2,050,000	12,150,000	810,143	577,918
Ending Balance			**1,774,836**	**11,333,613**	**238,357**	**-**	**-**
COMBINED WATER CAPITAL FUND (FUND 710)							
Beginning Balance			4,750,000	2,904,310	3,153,966	3,418,390	2,753,390
Revenues and Transfers							
Capacity Charges			103,960	118,956	122,524	126,200	129,986
Interest Earnings			237,500	130,700	141,900	153,800	123,900
Other Funding Source - TBD			-	-	-	-	-
Total Revs. and Trans.			341,460	249,656	264,424	280,000	253,886
Expenditures							
W&S Master Plan			25,000	-	-	50,000	50,000
Shop Upgrade			308,000	-	-	-	-
Mains - West Side			500,000	-	-	500,000	500,000
Mains - East Side			250,000	-	-	250,000	250,000
Storage			950,000	-	-	-	-
Looping			50,000	-	-	100,000	100,000
Contingency (5%)			104,150	-	-	45,000	45,000
Total Expenditures			2,187,150	-	-	945,000	945,000
Ending Balance			**2,904,310**	**3,153,966**	**3,418,390**	**2,753,390**	**2,062,276**

PURVEYOR	COST/ 25 UNITS
Atascadero	$39.40
Templeton	$39.78
Paso Robles	$43.25
Nipomo-Town Div.	$45.78
Nipomo-Blacklake	$47.48
Pismo Beach	$50.97
Grover Beach	$54.20
Arroyo Grande	$62.20
San Luis Obispo	$98.60
Cambria	$128.18
Morro Bay	$146.54