


TO: BOARD OF DIRECTORS
FROM: BRUCE BUEL 
DATE: FEB. 8, 2008

**AGENDA ITEM
E-2
FEB 13, 2008**

MERGER OF TOWN AND BLACKLAKE WATER SYSTEMS

ITEM

Confirm Blacklake equity surcharge calculation and set May 14, 2008 Protest Hearing for adoption of user rates for Blacklake water customers or take alternate action [PROVIDE POLICY DIRECTION].

HISTORY

In 2005, your Honorable Board determined that the Blacklake Water Booster Station was failing and needed to be replaced and NCSD retained Boyle Engineering to design a replacement Booster Station. Boyle submitted its design in October 2006 and your Honorable Board then retained Dee Jaspar and Associates to render a second opinion. In November 2006, your Honorable Board formed a committee to explore the possibility of merging the Blacklake Water Fund with the Town Water Fund to avoid the cost of replacing the Blacklake Water Booster Station. Dee Jaspar's design memorandum was received in December 2006, at which time your Honorable Board retained Boyle to prepare a memo comparing the two designs with the concept of merging the two Water Funds. Boyle submitted their Comparative Analysis in February 2007, which summarized the two cost opinions and the likely cost of a temporary fix until the decision could be made on the merger. In March 2007, your Board received Boyle's Interconnection Schematic memo and authorized staff to install a transfer pump to replace the old Booster Station on an interim basis pending closure on the merger proposal. In April 2007, your Honorable Board retained Bob Reed of the Reed Group to prepare an equity analysis to evaluate the equity payment necessary for Blacklake Water Fund customers to pay to the Town Water Fund if a merger of the funds was to occur. Mr. Reed's initial report was received in July and your Honorable Board ordered Mr. Reed to edit the original draft report and directed staff to notify the Blacklake Customers of their choices and to hold a briefing regarding these choices. Bob Reed submitted the Final Report on September 14, 2007 including a section of the calculation of the equity payment (See attached excerpt). Staff mailed notice of the informational hearing on September 13, 2007 and conducted the briefing on September 25, 2007. Your Board then discussed the merger at your October 10, 2007; October 24, 2007; November 14, 2007; and January 9, 2008 Board meetings. Your Honorable Board has received numerous submittals from Blacklake residents, a legal opinion regarding your discretion to merge the two systems and an opinion letter from the District's Auditor regarding the Generally Accepted Accounting Principles guiding calculation of the equity surcharge.

The ad hoc committee formed by the Board to discuss Blacklake fiscal issues met with Blacklake residents on January 28, 2008 and is scheduled to meet again on February 11, 2008. Either President Winn or Vice President Harrison can summarize the content of those meetings.

BACKGROUND

District Legal Counsel has opined that the Reed evaluation of the equity surcharge included in the September 14, 2007 Combined Water System Financial Plan and User Rates is defensible

but alternative plans not supported by substantial documentation would be less defensible. Your Honorable Board and the Blacklake Community have not supported retention of an expert to develop alternate equity calculations. To proceed with the merger option, your Honorable Board would need to proceed with a protest hearing on the equity surcharge based on the Reed report. The soonest that such a hearing could be set and provide for adequate notice would be May 14, 2008.

The Reed report recommends an equity payment of \$1,672 per equivalent 1" Meter, with the option of paying off the principal at 5% interest over a ten year period with a resultant Bi-Monthly Payment of \$35.52. At the same time, the rates that Blacklake Water Customers would pay would drop down to match the rates paid by the Town Customers (See Attached Rate Schedule). Given an average Blacklake Customer usage of 40 CCF every two months, the average water bill for a two month period in 2008 would drop from \$99.58 to \$89.93 (excluding the surcharge) and in 2009 the average Blacklake water bill would drop from \$116.27 to \$96.44 (excluding the surcharge).

The second option is to not merge the two systems. Under this scenario, the average Blacklake bi-monthly bill would increase in 2008 from \$99.58 to \$109.02 and in 2009 from 116.27 to \$139.64, assuming that the Water Fund lent the Blacklake Fund the \$800,000 estimated cost of constructing the new booster station. The Blacklake Community has not supported this concept.

A third option not previously considered would be to pledge the 2009 differential between the adopted Blacklake Water Rates and Town Water Rates as a mechanism to payback the \$1,062,594 equity buy-in over time. Given the adopted rates for 2009, Blacklake Customers are projected to pay approximately \$88,000 more in rates than they would if they were merged into a Combined Water System. If the Water Fund were to lend the \$1,062,594 to the Blacklake Customers at 5% interest and pledge a future stream of payments of \$88,000 per year, the loan could be paid off in approximately 18 years.

RECOMMENDATION

If your Honorable Board wishes to proceed with the merger of the two funds with the equity surcharge proposed in the September 14, 2007 Reed Report, you should confirm the Reed report; set a protest hearing for May 14, 2008; and direct staff to provide notice to each property owner.

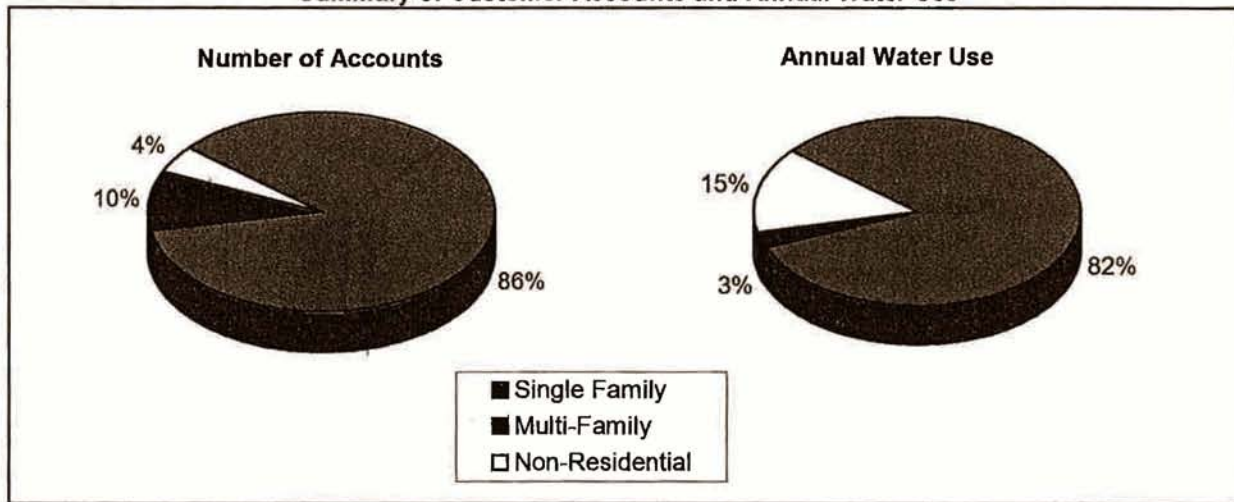
If your Honorable Board wishes to consider the third option described above, staff should be directed to refine the concept for consideration at your March 12, 2008 Board Meeting.

Staff recommends that your Honorable Board provide Policy Guidance.

ATTACHMENTS

- Excerpt from Reed Study
- Currently Adopted Water Rates

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.

The data presented in Exhibit III-4 reflects water use characteristics for the past 5 years.

Blacklake Equity Surcharge

As the District is considering the merger of the water systems for the Town and Blacklake Divisions, 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.

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 Accumulated 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

Because the financial plan analyses presented in Section II indicate that previously adopted water rates are sufficient to meet the combined water utilities needs for the next two years, no further water rate changes are recommended at this time. However, the study did include exploring other water rate structures (which might have been adopted had previously adopted water rates been shown to be insufficient for near-term needs), and the results of those analyses are described herein.

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 has adjusted water rates at the beginning of each calendar year, fiscal year revenue requirements were converted into calendar year revenue requirements. Estimated current calendar year water rate revenues as well as future water rate requirements for the next five years are summarized below. The percentage change in the rate revenue requirement differs from the percentage change in overall level of rates

**NIPOMO COMMUNITY SERVICES DISTRICT
ORDINANCE NO. 2005-103**

EXHIBIT "A"

APPENDIX A TO CHAPTER 3.03

WATER RATES AND CHARGES

BI-MONTHLY AVAILABILITY CHARGES*

(The bi-monthly availability charge shall take effect August 1, 2005, and Future increases shall take effect on January 1, of each succeeding year.)

TOWN DIVISION

SIZE OF METER	AUGUST 1, 2005	2006	2007	2008	2009
1 Inch or Less	\$16.76	\$18.43	\$20.64	\$22.71	\$24.52
Litigation Charge	\$6.32	\$6.32	\$6.32	\$6.32	\$6.32
1 ½ Inch	\$47.56	\$52.32	\$58.60	\$64.46	\$69.61
Litigation Charge	\$14.36	\$14.36	\$14.36	\$14.36	\$14.36
2 Inch	\$75.33	\$82.86	\$92.81	\$102.09	\$110.25
Litigation Charge	\$19.92	\$19.92	\$19.92	\$19.92	\$14.36
3 Inch	\$140.17	\$154.18	\$172.68	\$189.95	\$205.15
Litigation Charge	\$27.92	\$27.92	\$27.92	\$27.92	\$27.92
4 Inch	\$232.77	\$256.05	\$286.77	\$315.45	\$340.68
Litigation Charge	\$36.00	\$36.00	\$36.00	\$36.00	\$36.00
6 Inch	\$464.07	\$510.48	\$571.73	\$628.91	\$679.22
Litigation Charge	\$59.58	\$59.58	\$59.58	\$59.58	\$59.58
8 Inch	\$741.74	\$815.92	\$913.83	\$1,005.21	\$1,085.63
Litigation Charge	\$68.08	\$68.08	\$68.08	\$68.08	\$68.08

BLACKLAKE DIVISION

SIZE OF METER	AUGUST 1, 2005	2006	2007	2008	2009
1 Inch or Less	\$15.09	\$18.10	\$22.08	\$26.06	\$30.75
Litigation Charge	\$6.32	\$6.32	\$6.32	\$6.32	\$6.32
1 ½ Inch	\$41.73	\$50.07	\$61.09	\$72.08	\$85.06
Litigation Charge	\$14.36	\$14.36	\$14.36	\$14.36	\$14.36
2 Inch	\$65.74	\$78.89	\$96.24	\$113.57	\$134.01
Litigation Charge	\$19.92	\$19.92	\$19.92	\$19.92	\$14.36
3 Inch	\$121.81	\$146.17	\$178.33	\$210.43	\$248.31
Litigation Charge	\$27.92	\$27.92	\$27.92	\$27.92	\$27.92
4 Inch	\$201.90	\$242.28	\$295.58	\$348.78	\$411.56
Litigation Charge	\$36.00	\$36.00	\$36.00	\$36.00	\$36.00
6 Inch	\$401.93	\$482.32	\$588.42	\$694.34	\$819.32
Litigation Charge	\$59.58	\$59.58	\$59.58	\$59.58	\$59.58
8 Inch	\$642.06	\$770.48	\$939.98	\$1,109.18	\$1,308.83
Litigation Charge	\$68.08	\$68.08	\$68.08	\$68.08	\$68.08

*The above bi-monthly availability charge reflects the adjusted rate established by Ordinance 2003-95 to meet the District's financial obligations. Litigation charges off-set District financial obligations relating to the lawsuit entitled Santa Maria Valley Water Conservation District vs the City of Santa Maria, the Nipomo Community Services District, et al. When the District's financial obligation regarding this lawsuit have been satisfied, the litigation charge will be removed.

NIPOMO COMMUNITY SERVICES DISTRICT
ORDINANCE NO. 2005-103

EXHIBIT "A" (Continued)

APPENDIX B TO CHAPTER 3.03

WATER RATES AND CHARGES

(The bi-monthly usage rates shall take effect August 1, 2005, and future increases shall take effect on January 1, of each succeeding year.)

TOWN DIVISION

RESIDENTIAL USAGE RATES

	AUGUST 1, 2005	2006	2007	2008	2009
Tier 1 (0-40 Units)	\$1.12	\$1.23	\$1.38	\$1.52	\$1.64
Tier 2 (> 40 Units)	\$1.91	\$2.10	\$2.35	\$2.59	\$2.80

TOWN DIVISION

NON-RESIDENTIAL USAGE RATES

(Multi-family, Commercial, Irrigation, Agriculture, Industry and Construction)

	AUGUST 1, 2005	2006	2007	2008	2009
All Water Use	\$1.41	\$1.55	\$1.74	\$1.91	\$2.06

BLACKLAKE DIVISION

RESIDENTIAL USAGE RATES

	AUGUST 1, 2005	2006	2007	2008	2009
Tier 1 (0-40 Units)	\$0.97	\$1.16	\$1.42	\$1.68	\$1.98
Tier 2 (> 40 Units)	\$1.70	\$2.04	\$2.49	\$2.94	\$3.47

BLACKLAKE DIVISION

NON-RESIDENTIAL USAGE RATES

(Multi-family, Commercial, Irrigation, Agriculture, Industry and Construction)

	AUGUST 1, 2005	2006	2007	2008	2009
All Water Use	\$1.18	\$1.42	\$1.73	\$2.04	\$2.41