

**SACRAMENTO COUNTY WATER AGENCY  
CALIFORNIA**

For the Agenda of:  
January 27, 2009  
Timed Item 10:30 a.m.

To: Board of Directors

From: Department of Water Resources

Subject: Sacramento County Water Agency Zones 41/40 Proposed Water Rates Workshop

Supervisory  
District: All

Contact: Herb Niederberger, Division Chief, 874-5436  
Susan Purdin, Chief Financial and Administrative Officer, 874-3190

**Overview**

Sacramento County Water Agency (SCWA) is proposing Zone 40/41 water rate increases of approximately \$8.00/month in July 2009 and \$6.50/month in July 2010 for each typical single family residential customer. Today's workshop will explain the reasons for those upcoming increases, discuss initial outreach efforts and seek input from the Board regarding staff's assumptions.

**Recommendations**

Receive and file this report

**Measures/Evaluation**

Measures/Evaluation are not applicable to this agenda item.

**Fiscal Impact**

There is no fiscal impact associated with this workshop. Proposed future rate increases will be borne by existing and future SCWA customers.

**BACKGROUND**

For over 20 years SCWA has been planning and orchestrating the construction of a conjunctive use water supply program in Zone 40. Although approximately 85 percent of the existing water supply is groundwater, the water system has been sized to receive and distribute surface water. The system had been financed through a combination of developer fees and user charges on a "pay as you go" (PAYGO) basis. This changed in 2003 when SCWA formed the Sacramento County Water Financing Authority (SCWFA) for the purpose of issuing approximately \$50 million in revenue bonds. This money was used to build five small groundwater treatment plants, reclaimed water projects, regional conveyance projects, and other SCWA capital projects, as well as to pay for SCWA's share of Freeport Regional Water Project (Freeport Project) planning and preliminary engineering design.

In 2007 SCWFA issued \$414 million in revenue bonds which included refunding a portion of the 2003 issue. The 2007 Bond issue is funding SCWA's portion of the Freeport Project, including the ongoing construction of the intake and diversion structure on the Sacramento River and 16 miles of 84-inch pipelines, plus SCWA's 66-inch dedicated pipeline and the Vineyard Surface Water Treatment Plant (VSWTP).

Looking forward, SCWA intends to continue some PAYGO funding of projects. A modest amount of grants-in-aid are expected from the State of California. The remaining investment will be provided from internally generated funds consisting of revenues from rates and charges, impact fees, miscellaneous operating and non-operating revenues, and utilization of unencumbered reserve funds.

In 2007 the Board approved rate increases of approximately \$7.00 per month for each typical single family residential customer that were implemented on July 1, 2007, and again on July 1, 2008. At that time we notified the Board that additional increases would be proposed covering at least the next two fiscal years totaling \$14.00 per month (\$7.00 increase in July 2009 and another \$7.00 increase in July 2010) for each typical single family residential customer.

## **DISCUSSION**

SCWA is currently participating financially in the construction of an estimated \$500 million in capital improvements. This required the sale of more than \$400 million in revenue bonds to pay for a large component of this capital improvement program. The largest part of this program is SCWA's share of the Freeport Project and the associated VSWTP. The pipeline and intake components of the Freeport Project are scheduled to be complete in 2009, and VSWTP is scheduled for completion in late 2011. The debt service on this Bond issue is approximately \$25 million every year for the next 30 years with the first full year of debt service being next year (Fiscal Year 2009-10).

Since connection fees have historically represented 50 percent or more of SCWA's revenues, there is concern about the volatility of this revenue stream and the sensitivity of debt service coverage to connection fee revenue levels. This revenue, which is paid by developers and builders at the time a permit is issued, has proven to be highly variable and has declined dramatically over the last few years. Earlier this year staff was prepared to present a proposal before the Board to raise the Zone 40 Water Development Fee by \$990/edu (equivalent dwelling unit). However, because of the current impacts on the housing market, the proposal to raise this connection fee met with resistance from the Building Industry Association and was never considered by the Board. It is interesting to note that even in this reduced housing market this increase in the fee would have had the impact of reducing the Zone 40 User Fee by \$1.00 per month per customer, and our requested rate increase would be correspondingly less. Regardless, demonstrating a healthy reserve level, even in "low" growth years, will be critical to maintaining our bond rating.

The other primary source of revenue for SCWA comes from the water ratepayers. In late 2007 SCWA retained the services of FCS to undertake a formal rate design study focused on the ongoing shift from primarily flat rate revenue generation to revenue generated by fixed and variable rates associated with metered consumption and billing. The study also considered the cost of providing water service to the different classes of customers and conservation pricing

associated with Conservation Best Management Practices. FCS scrutinized cash flow projections for realistic financing, operating expense, and revenue assumptions and has recommended a conservative strategy to implement water rate increases over the next several years. The rate structure approved by SCWA should also provide for inflationary increases thereafter.

The revenue required to operate SCWA must be sufficient to cover operations and maintenance costs, PAYGO capital improvements, and to provide adequate reserve and unreserved fund balances. In addition, revenues must be at a level that will ensure required bond coverage will be met. More specifically, SCWA Enterprise Fund operating revenues, less operating expenses, must equal or exceed 125 percent of annual debt service. Failure to meet the bond coverage requirement would constitute a technical default. Per bond covenants SCWA is required to increase rates to meet coverage requirements.

Staff has also worked hard to reduce projected expenses. Over the last several years SCWA's Operations and Maintenance expenses have grown significantly, particularly in the areas of electricity costs and labor which make up 43 percent of those expenses. Staff has aggressively reduced future staff projections and incorporated substantial revisions to the short-term and long-term Capital Improvement Program (CIP) in both Zones 40 and 41. Furthermore, in an additional effort to reduce costs, staff has extended maintenance intervals between servicing on components of the water supply and delivery system along with reductions in discretionary programs while maintaining full compliance with regulatory and mandatory programs. Regardless, the revenue required to support SCWA's obligations is projected to grow from the \$42.7 million annually in FY 2007-08 to over \$78.9 million in FY 2013-14. The majority of the increase is due to the expected increase in debt service and the cost to operate and maintain the Freeport Project and VSWTP.

The projected rate increases are driven by three major factors: legal debt service coverage requirements; increases in the operating expenses associated with the operation of the Freeport Project intake and VSWTP, along with general inflationary increases; and capital expenditures and reinvestments. Beginning in FY 2009-10, SCWA will begin making full annual debt service payments of \$25.7 million on the 2007 bonds issued to fund the construction of the Freeport Project intake and VSWTP. This debt obligation was originally projected to be met largely with development fee revenues. However, due to the slowdown in housing starts, FY 2009-10 development fee revenues are expected to total \$10 million as compared to the initial projection of \$27.6 million.<sup>1</sup> Consequently, the projected FY 2009-10 rate increase request results from the need to meet the SCWA's legal bond coverage obligations. This coverage obligation will exceed the SCWA's cash operating expenses. Collected revenues will also serve a secondary purpose of funding capital reinvestments. While SCWA has mitigated operating cost increases associated with the VSWTP and the Freeport Project intake, some increased costs are unavoidable. These operation costs will partially begin in FY 2010-11. Finally, a system reinvestment strategy will begin in FY 2011-12 at 10 percent of the annual depreciation of the system assets. This program will be phased in over a ten-year period until SCWA begins collecting full annual depreciation funding in FY 2020-21.

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<sup>1</sup> 2005 Engineering Feasibility Analysis. Projected development fee revenues were projected at \$27.6 million in FY 2009-10, \$29.3 million FY 2010-11, and \$39.1 million in FY 2011-12.

At present the typical bill for a single family flat rate customer in Zones 40 and 41 is \$42.80 per month. A typical residence in Zones 40 and 41 with metered service pays an average of about \$42.50 per month. The proposed increases would result in a typical bill of \$50.79 per month for a single family flat rate customer in Zones 40 and 41 and \$57.29 per month in the following year. A typical residence with metered service would pay an average about \$53.24 per month for the first year and \$60.05 per month the following year. This represents an increase of 18.7 percent in the first year for a flat rate residential customer and a 25.3 percent increase for a single family metered customer.

A typical rate design might incorporate an inclining block rate, with higher volumetric rates for customers who have higher than average water consumption. This, in effect, punishes customers who consume higher volumes of water. In previous rate setting hearings low use customers complained about the equity of the increase. Staff requested and FCS compiled a rate design which rewards conservation. Therefore, staff is proposing a conservation discount for those metered customers that demonstrate a reduction in use. Staff's proposal offers a 20 percent discount in Zone 41 charges to customers who use less than 7 ccf per month (1 ccf = 100 cubic feet of water = 748 gallons; 14 ccf/two-month billing period or an average of 175 gallons per day over the billing period) and a 10 percent discount to those customers who use less than 15 ccf per month (30 ccf/two-month billing period).

A series of subsequent actions and hearings are scheduled to facilitate this rate proceeding. On February 3, 2008, the Board is scheduled to hear staff's request for authorization to initiate the rate setting process followed by a notice to customers on or before February 21, 2008. In order to have the rate increase effective July 1, 2009, staff has scheduled the Rate Increase Hearing for April 7, 2009, with final adoption on April 21, 2009.

## **CONCLUSION**

SCWA has embarked on an extensive CIP necessary to not only meet the demands of existing and future customers but to achieve conjunctive use of groundwater and surface water necessary to stabilize the groundwater in the Central Sacramento County Groundwater Basin. The bulk of the CIP has been financed through a series of bond issues with the consequence of the debt burden to be borne by existing and future SCWA customers. The burden of this CIP is further aggravated by the cost of regulatory compliance as well as future increases in labor, materials, and equipment costs that will also increase the revenue requirements of SCWA. Staff anticipates rate increases over the next several years to secure this revenue requirement. In each of the next two years staff will propose Zone 40/41 water rate increases of approximately \$8.00 and \$6.50 per month for each typical single family residential customer.

**FINANCIAL ANALYSIS**

There is no fiscal impact associated with this workshop. Proposed future rate increases will be borne by existing and future SCWA customers.

Respectfully submitted,

APPROVED:  
TERRY SCHUTTEN  
County Executive

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KEITH DEVORE, Director  
Department of Water Resources

By: \_\_\_\_\_  
PAUL J. HAHN, Administrator  
Municipal Services Agency

Attachment  
SCWA Map – Zones 40 and 41 Service Areas

cc: Herb Niederberger, John Coppola, Susan Purdin – DWR