

OTAY WATER DISTRICT
SPECIAL MEETING OF THE BOARD OF DIRECTORS
DISTRICT BOARDROOM

2554 SWEETWATER SPRINGS BOULEVARD
SPRING VALLEY, CALIFORNIA

THURSDAY
May 21, 2009
10:00 A.M.

AGENDA

1. ROLL CALL
2. PLEDGE OF ALLEGIANCE
3. APPROVAL OF AGENDA
4. PUBLIC PARTICIPATION – OPPORTUNITY FOR MEMBERS OF THE PUBLIC TO SPEAK TO THE BOARD ON ANY SUBJECT MATTER WITHIN THE BOARD'S JURISDICTION BUT NOT AN ITEM ON TODAY'S AGENDA

WORKSHOP

5. ADOPT RESOLUTION NO. 4136, APPROVING THE FISCAL YEAR 2009-2010 OPERATING AND CAPITAL BUDGETS; APPROVE FUND TRANSFERS FOR POTABLE, RECYCLED, AND SEWER; AND OBTAIN APPROVAL OF THE PROPOSITION 218 NOTICES AND DIRECT STAFF TO PROCEED WITH THE PROPOSITION 218 HEARING FOR THE RECOMMENDED RATE INCREASES (BEACHEM)
6. APPROVE A FIVE-YEAR RATE INCREASE AND FIVE-YEAR PASS-THROUGH OF WHOLESALER COST INCREASES (BEACHEM)
7. ADJOURNMENT

All items appearing on this agenda, whether or not expressly listed for action, may be deliberated and may be subject to action by the Board.

The Agenda, and any attachments containing written information, are available at the District's website at www.otaywater.gov. Written changes to any items to be considered at the open meeting, or to any attachments, will be posted on the District's website. Copies of the Agenda and all attachments are also available through the District Secretary by contacting her at (619) 670-2280.

If you have any disability which would require accommodation in order to enable you to participate in this meeting, please call the District Secretary at 670-2280 at least 24 hours prior to the meeting.

Certification of Posting

I certify that on May 15, 2009, I posted a copy of the foregoing agenda near the regular meeting place of the Board of Directors of Otay Water District, said time being at least 24 hours in advance of the special meeting of the Board of Directors (Government Code Section §54954.2).

Executed at Spring Valley, California on May 15, 2009.



Susan Cruz, District Secretary



AGENDA ITEM 5

STAFF REPORT

TYPE MEETING:	Special Board	MEETING DATE:	May 21, 2009
SUBMITTED BY:	<i>Rita Bell</i> Rita Bell, Finance Manager	W.O./G.F. NO:	DIV. NO. All
APPROVED BY: (Chief)	<i>Joseph R. Beachem</i> Joseph R. Beachem, Chief Financial Officer		
APPROVED BY: (Asst. GM):	<i>G.A. Alvarez</i> German Alvarez, Assistant General Manager		
SUBJECT:	Adopt Resolution No. 4136 to Approve the FY 2009-2010 Operating and Capital Budget; Approve Fund Transfers for Potable, Recycled, and Sewer; and Obtain Approval of the Proposition 218 Notices and Direct Staff to Proceed with the 218 Hearing for the Recommended Rate Increases		

GENERAL MANAGER'S RECOMMENDATION:

That the Board:

a) Adopt Resolution No. 4136 of the Board of Directors of Otay Water District to approve the Fiscal Year 2009-2010 Operating and Capital Budget.

b) Approve the following fund transfers:

Potable:

General Fund to Replacement	\$2,710,000
General Fund to Designated Betterment	\$3,700,000
General Fund to Sewer General Fund	\$200,000

Recycled:

General Fund to Replacement	\$950,000
General Fund to Designated Expansion	\$1,610,000
General Fund to Designated Betterment	\$110,000

Sewer:

General Fund to Designated Betterment	\$753,000
Expansion to Designated Betterment	\$410,000

c) Direct staff to proceed with the Proposition 218 hearing and notices for the recommended rate increases, with changes as approved by the General Manager.

COMMITTEE ACTION: _____

See Attachment A.

PURPOSE:

To obtain approval of the Fiscal Year 2009-2010 Operating and Capital Budget; various fund transfers; adoption of Resolution No. 4136; and direction to move forward with the Proposition 218 hearing and notices. The average water rate increase being recommended is 19.9% and the sewer rate increase averages between 7.2% and 9.6% with two options being presented.

BACKGROUND:

Each year the District goes through a rate setting process with new challenges. The process begins in January of each year and ends with the implementation of rates in the following January. This year, CWA is not only raising rates by an unprecedented 18.1% but is also raising rates on September 1st, four months earlier than the typical process. This compressed timeline creates significant time constraints as the 218 notices must now be ready at the same time the budget is approved. Staff has prepared both the Operating Budget and CIP Budget and has water and sewer rates ready for presentation to the Board.

DISCUSSION:

This year, the challenges for water are the unprecedented water cost increases by CWA & MWD, the need to strengthen debt coverage ratios, continued economic recession, and reduced water sales. The focus on the sewer side is on higher costs due to regulations and the decision on whether to maintain existing reserves or draw down the reserves while revenues are increased gradually. The following discussion and the attached presentation review these significant issues.

Water Costs

The Fiscal Year 2010 has a number of challenges that have an impact on the water and sewer rates. The potable water suppliers, CWA and MWD, have had unprecedented rate increases of 18.1% and 21.1%, respectively. This is primarily a result of the water supply problems that face the State of California. The cost of securing a water supply, in this water crisis, is driving up the cost of water. In addition, new CWA and MWD facilities costs are adding to this cost pressure. Finally,

with lower water sales, due to conservation messages and economic challenges, the fixed costs are being spread over a smaller sales base. All these factors play a significant role in the higher cost of water to the District.

With water costs representing 49% of the District's operating budget, it is understandable that nearly half of the rate increase is providing the \$3.86 million more necessary to purchase approximately 8% less water than was planned to be purchased in the prior year. Likewise, some District customers will see that they will pay more for less water as these difficult times continue.

Debt Coverage and Credit Ratings

The District has had two credit rating upgrades over the past three years. From A+ to AA-, then from AA- to AA. While the credit rating is an overall rating and many factors are considered when these ratings are determined, one of the main financial ratios considered is the Debt Coverage Ratio. This ratio is the measure of net revenues compared to debt service. The District has historically held the "no growth" version of the debt coverage ratio over 125% with a target of 150%. In the 2009 budget approval, this ratio was brought down to 100% in order to alleviate the unusually high rate increases that were anticipated. This level was considered to be sufficiently high to retain a strong overall financial position, and in fact, the second upgrade occurred after this position was taken. However, with the economic difficulties experienced over the past year there are new expectations and the definition of a strong debt coverage has changed.

With a 19.9% rate increase, the District will raise this ratio for 2010 to 208%, a strong position. However, in 2011 with the debt service on the proposed new debt mentioned below the ratio will drop to 140%. This is still a strong position. Staff evaluated how secure this level was if sales fluctuated by significant amounts. The analysis shows that a drop in sales of 4.1% more than expected would still leave the District at 125% in 2011. The two year outlook is where the ratio is the lowest which leaves the District time to react in the rate setting of the 2011 budget. In addition, the District will have the ability to implement drought pricing if sales drop significantly below the 2011 budget expectations.

Financing Plan

The District uses a comprehensive approach to financing. The Finance Policy provides guidance on debt issuances and

refinancing and the Reserve Policy provides guidance on both fund transfers and reserve balances. With these policies, staff formulates a six-year financing plan that identifies the timing and amounts of debt issuance, the level of rate increases, debt coverage ratios, reserve balances, and necessary transfers. Staff is proposing that the District issue \$41 million of new debt in order to finance the next two years of capital improvements. The CIP is also supported by \$10.4 million of the transfers requested above.

With the proposed debt and transfers, the District will be able to maintain all reserve levels at or above target, as per the Reserve Policy, and provide sufficient funds to finance the capital improvements for fiscal years 2010 and 2011.

Water Sales

In the 2009 budget process the District anticipated that water sales would decline as a result of the drought and the conservation messages. The 2009 projected water sales were reduced by a 2% conservation factor generating a budget of 38,783 acre-feet of purchases from the District's water suppliers. With the economic recession added to the conservation messages, the actual level of conservation through March 2009 has exceeded the 2% conservation projection by 3.8% (5.8%).

The significance of the sales level was again highlighted in the 2010 budget cycle by the implementation of allocations by CWA. Prior to knowing the amount of the allocation, the focus was on the determination of the financial risk of selling more water than the allocation and the probability of this occurring. Projected water sales became one of the two key pieces of information in determining this risk. If the allocation was exceeded, the financial cost to the District would be substantial at twice the Tier 2 water rate.

With the difficulty of determining an accurate sales projection in this economy and with the drought messages, staff hired the firm of Rea & Parker to perform a survey on planned water conservation of the District's residential customers. District staff supplemented this survey by contacting other classes of customers. The results were used to project a future sales reduction of 4.8%. This conservation factor was then placed into the District's Rate Model, along with projections of meter sales and conversions of potable customers to recycled, to determine a projected water purchases amount of 35,554 acre-feet.

Due to the substantial investment in recycled water and the conservation already being achieved by Otay customers the allocation for the District is well above the anticipated purchases in 2010. The allocation level is set at 39,832 acre-feet while the projected purchases for 2010 are only 35,554 acre-feet, leaving a 10.7% cushion before the District is at risk of incurring penalty pricing.

With these two pieces of information, projected sales and the allocation, the District has determined that, even with the high uncertainty of projecting sales, there is only a minimal chance of exceeding the allocation level. This leaves a positive financial impact of selling more than budget and the standard negative impact of selling less than budget. The District's focus on sales now is centered on the possibility of greater conservation than is anticipated.

Variable revenues on water sales represent 72% of District's budget with variable costs representing 38% of budgeted expenses. The District will monitor sales closely in order to determine the financial impact of lower than expected sales. While reserves are sufficient to cover even a dramatic cut in sales, the debt coverage ratios need to be maintained to insure that the District can retain its ability to issue additional low cost debt.

Adjustment to Tiers

Typically, rate studies are not revisited for four to five years. However, with the change in customer's consumption, District staff, in concert with the firm of PBS&J, revisited the tier structures of the District's customer classes. The 2009 rate study methodology was used to propose modifications to the consumption levels of each tier. The winter average is the break point for the base tier and the middle tier. The summer average is the break point for the highest tier. The new tiers have a modest impact on rates, reducing the anticipated rate increase by 0.4%. This also keeps the District in sync with the rate study methodology. The detailed changes can be found in the attached proposed 218 notices.

Relative Position to Other Districts

Annually, the District performs a survey of how Otay's rates compare to other water providers in the county. For many years the District has remained in the lower half of this comparison. It is expected that all water providers in the county are facing the same rate pressures as they are all purchasing water from

CWA and MWD, some to a greater extent than others, depending on the relative dependence on CWA water. Many water districts are looking at implementing rates that are close to 20% or greater. The District's survey, shown in the attached presentation, shows that an average water user in the county, 15 units, will be charged the seventh lowest rates if they are an Otay customer. A conserving customer, 10 units, will be charged the sixth lowest rates if they are an Otay customer.

Water Rates

In addition to the high cost of water, reduced water sales puts additional pressure on the rate increase required to balance the budget and maintain a healthy financial position. This year, because of the water shortage and the pending allocation to be set by CWA, projected water sales and purchase levels are even more important in the budgeting process. The starting point for water sales was the past 12 months of consumption. This was considered a good starting point because it takes into account some of the economic pressures and drought messages that customers will continue to experience.

To better estimate the future conservation of customers, staff conducted two surveys; one conducted by the professional survey firm of Rea and Parker and one by Otay's staff. Rea and Parker contacted single-family residential customers, and customer service and conservation staff contacted master metered, commercial, public, and landscape customers. Customers were asked about how they might be changing their consumption levels as a result of both the economic pressures and the conservation messages that they have heard. They were also asked about their plan to achieve this conservation level. The results of these surveys were analyzed, and the following conservation factors were used in the Rate Model:

- Single-family and mastered metered residential customers conservation is 5.3%
- Landscape and recycled customers plan to cut consumption by 10%
- Public and commercial customers have no consumption changes

The most realistic set of the above stated factors have been used in the FY 2010 budget creation and rate setting. Although we cannot predict with certainty how these factors will actually occur, collecting as much information as possible improves the accuracy of the most likely financial scenario. Using this information in the budget process helps prepare the District to anticipate likely outcomes.

Sewer Rate Options

There are two options being presented to the Board for sewer rate increases. This year, due to the increased regulations, staff will be budgeting a greater level of monitoring of the sewer system. This monitoring effort makes up the majority of the \$400,000 increase in expenses in this year's sewer budget. This is a substantial increase on only a \$2.4 million budget.

The first option (staff's recommendation) is to implement a 7.2% average rate increase over the next six years, raising the operating revenues over time to be on par with operating expenses. This would draw down the sewer general fund reserves by \$1.3 million. This drawdown is consistent with the Reserve Policy as the general fund is over the target level and will even exceed the maximum as the potable general fund repays the transfer that was made last year. This option will place a draw down of general funds into the budget in order to balance the budget in the next six years. No sewer funds are under target levels, the general fund will exceed target levels, and the replacement fund currently exceeds the maximum level.

The second option is to implement a 9.6% average rate increase over the next six years, which will draw down reserves in the first three years but replenish them in the later three years. Following this six-year time period the rate increases would drop significantly as the operating revenues would be well above operating expenses.

Efficiencies Through Strategic Management

In addition to the budget and rate setting process, the District's focus on strategic planning has played a positive role in the financial strength of the District. By managing staffing, automating processes, and implementing best management practices, the District has become more efficient, therefore more cost effective, as demonstrated by its relative rate position and bond rating among other agencies in the region.

Operating Budget

The Fiscal Year 2009-2010 balanced budget supports the pass-through of CWA's increases in water costs, effects of reduced water sales, an increased Capital Budget, new programs to meet regulatory requirements, and the strengthening of the District's financial position. The budget includes a 19.9% rate increase for potable and recycled, and a 7.2% rate increase for sewer. The Rate Model projects a 19.9% increase for the next two years and a 7.0% increase for the following four years.

Rate Implementation - Water

The 19.9% rate increase is being implemented for both potable and recycled customers. Staff is recommending an increase in the variable water rate to all classes of potable customers of 20.9%, and the adjustment of the tiers in accordance with our most recent rate study, to reflect the lower water consumption. The fee increases for a single-family residence is \$7.02 to \$9.77. The MWD/CWA pass-through fee is proposed to increase 39.2% to fully collect the fixed cost by our water providers as shown below:

Customer Service Charge	\$1,148,800
Emergency Storage Charge	\$2,246,600
Infrastructure Access Charge	\$1,344,900
Capacity Reservation Charge	\$628,800
Readiness-to-Serve Charge	\$1,140,700
Total MWD/CWA Fixed Charges	\$6,509,800

An increase in the system fee of 5.5%, from \$13.83 to \$14.58 for a single-family residence, is also necessary to balance the budget. This mix of increases between MWD/CWA and system fees brings the fixed revenue sources closer to the 30% maximum recommended by the Best Management Practices (BMP) 11. The fixed fee components of the District's revenues are important to maintain revenue stability. However, maintaining a balance with variable revenue promotes conservation.

For the recycled water customers, staff is also recommending the same percentage increases of 20.9% in the variable water rates, and 5.5% for the system fee. Recycled water rates are set at 85% of the potable irrigation rate in accordance with our recycled rebate agreement with CWA.

Rate Implementation - Sewer

In Fiscal Year 2009, a 4.6% rate increase was projected based on cost estimates at the time. Now, due to the higher cost associated the regulatory requirements of the Sewer System Management Plan, the estimated rate increase is increased to 7.2%. Since sewer costs only represent 3.7% of the total Operating Budget, even relatively small changes in the budget can cause significant fluctuations in the sewer rate.

Budgeted Revenues

The budgeted revenues include an increase in potable water sales of 14.7% and in recycled water sales of 19.8%. These increases, despite reduced water sales of 8.3% for potable and 4.5% for recycled, because of the economy and conservation, are offset by a 12.4% rate increase on January 1, 2009 and another 19.9% rate increase planned for September 1, 2009.

Sewer budgeted revenues increased 17.1% due to half year's increase from last fiscal year of 4.6% (one-half of this is 2.3%), another half year for this year's planned 7.2% increase, and a small amount of growth in this area of 0.6%. Another factor is the implementation of the third year of the winter-consumption based rate structure, where the maximum charge is now based on 30 units (after the 15% discount) increasing the charge for higher consumption customers. This change is revenue neutral to the District, but it will bring the District into compliance with Best Management Practices 11 which encourages conservation and ensures users pay their fair share for services.

Other changes in the Operating Revenues include the following:

- Due to lower meter sales, Meter Fee Revenues are expected to decrease by 59.2%.
- Capacity Fee Revenues are expected to increase by 7.3% due to more than expected work in the planning area.
- Betterment Fees for Maintenance are expected to decrease 36.2% due to more planned maintenance, which reduces the more costly corrective maintenance.
- Annexation Fees are expected to decrease by 75.1% due to lower meter sales and fewer parcels requiring to be annexed.
- Property Tax revenues are expected to decrease 5.3% due to an anticipated reduction in assessed values of 6%.
- Non-Operating Revenues are expected to slightly decrease by 2.9%.

Property Tax

For Fiscal Year 2010, there is an anticipated Proposition 1A borrowing of 8% of the property taxes built into the Rate Model as a transfer out of funds to the state.

Expenses

The most significant item in expenses is the 12.2% increase in water purchases which is due to the same conservation and CWA

price increases mentioned above. This increase has both a variable and fixed component. The total increase in variable potable water costs is \$2,850,100. The price component of this increase is expected to be \$119 per acre-foot for purchases from CWA. The fixed costs paid to CWA and MWD are projected to increase the District's expenses by \$1,189,900 which is highlighted in the section above. Recycled water costs are expected to decrease by \$178,800. This is mostly due to a volume decrease of 3.3% combined with a reasonable price inflator by the City of San Diego. The estimated increase was based on CPI inflators from the start of the contract and would be an increase of 27.2% on January 1, 2010.

Sewer costs are expected to increase by \$411,300 due to increases in the state regulatory requirements of the Sewer System Management Plan.

Power costs are budgeted to decrease 6.6% due to the volume decreases of water sales requiring less pumping costs, combined with an anticipated SDG&E rate increase of 3.5% on January 1, 2010.

Labor and benefits costs are expecting a minimal increase of 0.16% or \$27,400. These changes are due to the following:

- Reduction in FTE by 2.75 and position changes decrease of \$166,900
- Cost of living of 3% and merit increases pursuant to current MOU increase of \$502,900
- Changes in the vacancy factor and vacation and sick leave decrease of \$23,900
- Reduction in overtime of \$30,800
- Benefit cost increases of \$221,100
- Increase of charges to CIP which reduces cost by \$475,000

The Administrative Expenses decreased by 10.2% or \$605,900. This is due largely to three main factors:

1. The shifting of three projects in the engineering department to the CIP budget based on further analysis of this work. The three projects are Asset Management for \$300,000, Multiple Species for \$141,000, and San Miguel Habitat Management for \$225,000.

2. Increases in the pump station paving program of \$80,000 and an increase in bad debt expense of \$70,000 due to the current economic conditions.
3. A decrease in the overhead allocation of \$92,600 due to the shifting of cost between Operating and CIP budgets.

The Materials and Maintenance budget experienced an overall decrease of 1.84% or \$71,200. Two large decreases are due to reduced fuel cost (\$137,600) and a slight decrease in the Metropolitan charge of \$60,900. An offsetting increase in the Safety budget of \$124,400 is for disaster preparedness expenses for the Emergency Operations Center, which is one of the District's Strategic Plan items.

Funding to reserves is increasing by \$3.8 million as compared to last year. This year, the funding is needed to keep the Betterment and Replacement Reserves on target and to fund these projects. This funding will keep reserve levels in compliance with the Reserve Policy. Additionally, the Operating budget is funding the Potable and Sewer General Fund Reserves in the amount of \$1.5 million to keep these reserves on target and to strengthen the District's debt coverage ratio.

Capital Improvement Program (CIP) Budget

Each year with the budget process, the Engineering Department updates the CIP Budget. This year, the six-year CIP budget has increased by \$52 million from last year's CIP. This increase is mostly a result of the integrated water resources plan and new water supply projects developed from this plan. These new projects and cost changes to existing projects are reviewed and approved along with the Operating Budget. The following process is used to prepare the CIP Budget:

- o CIP projects selected are based on CIP criteria, the Water Resources Master Plan (WRMP), the Urban Water Management Plan (UWMP), and Integrated Water Resources Plan (IRP).
- o The CIP goes through an iterative process to meet the criteria of financial, growth, and service levels.
- o The CIP targets expenditures for the next six years.

The Engineering staff uses the following general criteria to determine the reasonableness of a project before it is included in the CIP Budget:

- o Existing Facility Conditions

- o Operating System Conditions
- o Water and Sewer System Deficiencies
- o Regulatory and Permitting Requirements
- o Developer Driven Schedules
- o Economic Outlook and Growth Projections
- o Board and Management Directives

This year, the CIP Budget includes the following amounts by project category. Project details within each of the categories are located in Attachment C under the Capital Budget tab.

Capital Backbone	\$28.7
Developer Reimbursement	0.1
Replacement and Renewal	6.7
Capital Purchases	<u>1.8</u>
Total (millions)	\$37.3

There are a total of 83 projects in the current six-year CIP plan. Each project is listed in the FY 2009-10 Preliminary Operating and Capital Budget (Attachment C). The total six-year cost of the 83 projects is \$222.4 million.

Staff has attempted to present the most realistic set of factors and assumptions based on information received from various sources, including water suppliers MWD and CWA, vendors such as SDG&E, and other suppliers, and finally other economic indicators affecting revenues such as property taxes and lease agreements.

By being proactive, the District can better educate its customers and ensure we take the least amount of risk, minimizing the rate impacts, and ensuring the fiscal strength of the District throughout these difficult economic times.

FISCAL IMPACT:



The recommended balanced budget totals \$75.7 million for Operating and \$37.2 for the CIP. With budget approval, the District will move forward into the 2010 Fiscal Year with clear financial direction. Staff is recommending to set rates based on the same methodology as the recent rate study, and prepared the Proposition 218 notices with recommended rate changes which support this budget. This budget provides sufficient funding to pay increased water costs; continued funding for the District's administration, maintenance, and operations; strengthens our financial position, and is consistent with the Strategic Plan and Reserve Policy.

STRATEGIC OUTLOOK:

The District ensures its continued financial health through long-term financial planning and debt planning.

LEGAL IMPACT: _____

None.



General Manager

Attachments:

- A) Committee Action Form
- B) Fiscal Year 2010 Budget Workshop Presentation
- C) Resolution No. 4136
- D) Preliminary Operating and Capital Budget Fiscal Year 2009-2010
- E) Proposition 218 Notice - Residential Water and Sewer Rates
- F) Proposition 218 Notice - Residential Water Rates
- G) Proposition 218 Notice - Residential Sewer Rates
- H) Proposition 218 Notice - Public and Commercial Water Rates
- I) Proposition 218 Notice - Landscape, Agriculture & Construction Water Rates
- J) Proposition 218 Notice - Recycled Water Rates
- K) Proposition 218 Notice - Commercial Sewer Rates
- L) Proposition 218 Notice - Land Only



ATTACHMENT A

SUBJECT/PROJECT:	Adopt Resolution No. 4136 to Approve the FY 2009-2010 Operating and Capital Budget; Approve Fund Transfers for Potable, Recycled, and Sewer; and Obtain Approval of the Proposition 218 Notices and Direct Staff to Proceed with the 218 Hearing for the Recommended Rate Increases
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COMMITTEE ACTION:

The Finance, Administration, and Communications Committee recommends that the Board adopt Resolution No. 4136 to approve the FY 2009-2010 Operating and Capital Budget; approve fund transfers for potable, recycled, and sewer; and obtain approval of the Proposition 218 notices and direct staff to proceed with the 218 hearing for the recommended rate increases.

NOTE:

The "Committee Action" is written in anticipation of the Committee moving the item forward for board approval. This report will be sent to the Board as a committee approved item, or modified to reflect any discussion or changes as directed from the committee prior to presentation to the full board.

RESOLUTION NO. 4136

A RESOLUTION OF THE BOARD OF DIRECTORS OF
OTAY WATER DISTRICT ADOPTING THE
FISCAL YEAR 2009-2010
OPERATING AND CAPITAL BUDGET

WHEREAS, the Otay Water District Board of Directors have been presented with a budget for the operation of the Otay Water District for Fiscal Year 2009-2010; and

WHEREAS, the Operating and Capital Budget has been reviewed and considered by the Board, and it is in the interest of the District to adopt a budget for said year; and

NOW, THEREFORE, BE IT RESOLVED, DETERMINED AND ORDERED by the Board of Directors of the Otay Water District that the Operating and Capital Budget for the operation of the District, incorporated herein by reference, is hereby adopted as the District's budget for Fiscal Year 2009-2010.

PASSED, APPROVED AND ADOPTED by the Board of Directors of Otay Water District at a special board meeting held this 21st day of May 2009, by the following vote:

Ayes:
Noes:
Abstain:
Absent:

President

ATTEST:

District Secretary

ITEM 5

Adopt Resolution No. 4136, Approving the Fiscal Year 2009-2010 Operating and Capital Budgets; Approve Fund Transfers for Potable, Recycled, and Sewer; and Obtain Approval of the Proposition 218 Notices and Direct Staff to proceed with the Proposition 218 Hearing for the Recommended Rate Increases

Please reference:

Attachment 1 for the Powerpoint Presentation and

Attachment 2 for Preliminary Operating and Capital Budget for Fiscal Year 2009 – 2010

posted to
Otay Water District website.

ITEM 5

Adopt Resolution on No. 4136, Approving the Fiscal Year 2009-2010 Operating and Capital Budgets; Approve Fund Transfers for Potable, Recycled, and Sewer, and Obtain Approval of the Proposition 218 Notices and Direct Staff to Proceed with the Proposition 218 Hearing for the Recommended Rate Increases

Please reference Attachment 3 "Proposition 218 Notices" posted to Otay Water District website.



AGENDA ITEM 6

STAFF REPORT

TYPE MEETING:	Special Board	MEETING DATE:	May 21, 2009
SUBMITTED BY:		W.O./G.F. NO:	DIV. NO. All
APPROVED BY: (Chief)	Joseph R. Beachem, Chief Financial Officer		
APPROVED BY: (Asst. GM):	 German Alvarez, Assistant General Manager		
SUBJECT:	Approve a Five-Year Rate Increase and Five-Year Pass-through of Wholesaler Cost Increases		

GENERAL MANAGER'S RECOMMENDATION:

That the Board authorize the staff to send Proposition 218 notices informing the recipients that the District proposes to adopt:

- A five-year rate increase, not to exceed 10%, on all water and sewer rates and charges to cover the added cost of providing water and sewer service. This rate increase does not include the added cost of wholesale services covered by the pass-through rate increase below.
- A five-year pass-through rate increase of water and sewer costs from the District's wholesalers and sewer service providers such as the Metropolitan Water District of Southern California (MWD), San Diego County Water Authority (CWA), County of San Diego, and the City of San Diego.

COMMITTEE ACTION: _____

Please see Attachment A.

PURPOSE:

The purpose of the notices, the proposed schedule of rate increases, and the proposed pass-through is to allow for timely and necessary periodic rate increases within the limitations specified on the notices.

ANALYSIS:

With the passing of Proposition 218, the process of implementing rate changes became more restrictive with stringent restrictions on the notice, a required hearing, and an additional 45-day

waiting period. In FY 2010, due to the economic challenges, CWA and MWD have implemented rate increases four months earlier than is typical. This seriously compresses the time available to the District to react. Many districts have looked to a Prop 218 five-year option that allows for more rapid rate implementations at a lower cost. Staff is recommending that the District also use this option, allowing the District to be better able to react in a timely fashion to untimely wholesaler rate increases.

Water Pass-through

The water increase proposed to take effect on September 1, 2009, would contain adjustments to pass-through the increases being implemented within the next few months by the District's water wholesalers, namely MWD, CWA, and the City of San Diego. The District has been informed that CWA and MWD do not expect to implement additional increases during 2010. However, they do expect to implement increases in January 2011, and annual rate increases in each subsequent year through 2014. The proposed 218 notices have the following language in them that will allow for an annual pass-through of these costs without an additional step of the annual 218 notices and hearing.

"..authorize timely and necessary periodic increases of rates and charges to pass-through increased or decreased charges implemented by the District's public agency wholesalers, such as the San Diego County Water Authority (CWA), the Metropolitan Water District of Southern California (MWD), and the City of San Diego."

The District would be required to provide a 30-day notice of rate changes but would not be subject to a stringent 218 public hearing process or protest. The District has always provided notice of increases to its customers even before the 218 requirements. This language will cover the next five years.

Sewer Pass-through

The sewer increase proposed to take effect on January 1, 2010, would pass-through the increases from the City and County of San Diego for sewer collection and treatment. It is expected that the city will also implement annual increases in each subsequent year through 2014. Just as in the 218 notices for water, the proposed sewer 218 notices have language that will allow for an annual pass-through of these wholesaler costs without an additional step of the annual 218 notices and hearing.

Five-year Rate Increase

The proposed 218 notices also include language notifying water and sewer rate-payers and property owners of the proposed five-year 10% increase. This is a not to exceed percentage and actual increases would not exceed the cost of providing service. These increases would also be subject to a 30-day prior written notice, but would not be subject to additional 218 hearings or protests. The language in the notices is as follows:

"The District is proposing to adopt a five-year schedule of proposed rate increases to be implemented beginning on September 1, 2009 and periodically thereafter through June 30, 2014. Under the proposed rate schedule, the average customer's water rates will increase by an amount sufficient to cover cost increases related to providing water service, but not to exceed 10% per year."

Each 218 notice includes tables showing the proposed FY 2010 rate increases followed by assumed 10% rate increases for the following four years. If the cost of providing the service, not taking into account any pass-through costs, exceeds 10% for any year, the District will need to provide a Prop 218 notice before implementing an applicable rate increase. Any increase under this provision will go through budget and Board approval.

FISCAL IMPACT: 

This action has no direct financial impact. If after the 218 hearing this is approved, then the rate setting process will become less complicated and costly, saving the District via fewer mailings, less legal review, and reduced staff time.

STRATEGIC GOAL:

Ensure financial health through formalized policies, prudent investing, and efficient operations.

LEGAL IMPACT: _____

None.

General Manager

Attachments:

- A) Committee Action Form
- B) Legal Opinion



ATTACHMENT A

SUBJECT/PROJECT:	Approve a Five-Year Rate Increase and Five-Year Pass-through of Wholesaler Cost Increases
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COMMITTEE ACTION:

The Finance, Administration, and Communications Committee recommends that the Board approve that provisions be placed in the 218 notices to adopt:

- A five-year rate increase, not to exceed 10%, on all water and sewer rates and charges to cover the added cost of providing water and sewer service. This rate increase does not include the added cost of wholesale services covered by the pass-through rate increase below.
- A five-year pass-through rate increase of water and sewer costs from the District's wholesalers and sewer service providers such as the Metropolitan Water District of Southern California (MWD), San Diego County Water Authority (CWA), County of San Diego, and the City of San Diego.

NOTE:

The "Committee Action" is written in anticipation of the Committee moving the item forward for board approval. This report will be sent to the Board as a committee approved item, or modified to reflect any discussion or changes as directed from the committee prior to presentation to the full board.



April 28, 2009

Members of the Board of Directors and
Mark Watton, General Manager
Otay Water District
2554 Sweetwater Springs Blvd.
Spring Valley, California 91978-2096

Re: Analysis Concerning the Proposed Schedule of Rate Increases

Gentlemen:

We have been informed that, as a result of California’s water shortage, the Metropolitan Water District (MWD) and the San Diego County Water Authority (CWA) anticipate increases on the costs of water sold to the Otay Water District (Otay) and other retailers. At the same time, the amount of water provided to Otay may be significantly decreased. Due to these changes, Otay may need to raise additional revenues to cover increased costs on a short notice.

To ensure that its customers share the increased costs, Otay may need to increase water rates and also may need to pass through any MWD and CWA cost increases (“pass through”) as promptly as possible, within applicable provisions of the law. Otay has requested guidance as to how to implement these increases, especially as related to the “pass through,” and the procedural requirements for providing notice to its customers. This correspondence addresses these issues in detail.

I. General Background Regarding Rate Schedules and Formulas

Otay may establish rate schedules and formulas that are “reasonably related” to the benefits received by its customers. See Cal. Const., Art. XIII D, § 6, subd. (b)(1) and (3); *Howard Jarvis Taxpayers Assn. v. City of Roseville* (2002) 97 Cal.App.4th 637, at 648. Generally, in order for pricing methodology for water rates to comply with the substantive provisions of Article XIII D, Section 6, of the California Constitution, the revenues derived from the rates must not exceed the reasonable cost of providing water service, taking into account both basic and incremental costs. Rate calculations may include a schedule of adjustments, including a clearly-defined formula for adjusting for inflation; provided that the property-related charge, as adjusted for inflation, does not exceed the cost of providing the service. Further, revenues should not exceed the proportional cost of providing water service attributable to a customer’s parcel, as determined by considering: (1) customer classes based on service characteristics, demand patterns, and other factors; (2) basic use allocations; (3) meter size; (4) metered volume of water consumed; and (5) the public agency’s discretionary allocation of incremental costs between and among the increments of water use subject to conservation charges.

It should be noted that many public agencies, including Otay, have adopted tiered water rate structures. These structures are intended to encourage conservation by imposing higher charges per unit of water as the amount of consumption increases. This form of "inclining block" rate structure was validated in *Brydon v. East Bay Municipal Water District* (1994) 24 Cal. App.4th 178. After the adoption of Proposition 218, in the year 2000, and more importantly, after the court's decision in *Bighorn Desert-View Water Agency v. Virgil* (2006) 39 Cal. 4th 205, ruling that water is a property-related service, it was unclear whether a tiered rate structure could comply with the provisions of Proposition 218. Effective January 1, 2009, AB 2882, signed into law by the Governor in 2008, reaffirms the tiered structure and incorporates a requirement into the Water Code to implement tiered rates to prevent the waste and unreasonable use of water. Regardless of whether an agency implements a tiered-rate structure based on allocation or other method, the provisions of Article XIII D, Section 6, of the California Constitution apply.

II. Pass Through Rate Increases to Its Customers

Effective January 1, 2009, AB 3030, which added section 53756 to the California Government Code, established certain requirements for implementing rate increases structured to include annual inflationary increases or to authorize the agency to pass through increases or decreases in the cost of purchasing wholesale water from another agency. Such requirements must be read in light of the provisions of Article XIII D, section 6, of the California Constitution.

Section 53756 provides that a public agency, such as Otay, may adopt a schedule of fees or charges authorizing automatic adjustments that *pass through* increases in wholesale charges for water or adjustments for inflation. In compliance with the provisions of Section 53756, when adopting a schedule of fees or charges that implements a pass through, the following applies:

- (a) The schedule of fees or charges may not exceed five years;
- (b) The schedule of fees or charges may include a schedule of adjustments. If applicable, the schedule of adjustments may include a clearly defined formula to make annual adjustments for inflation. Regardless of the proposed form of the schedule of adjustments, and any formula used in connection therewith, the property-related fee or charge, as adjusted, should not exceed the cost of providing the service; and
- (c) The schedule of fees or charges may provide for automatic adjustments that pass through the adopted increases or decreases in the wholesale water charges established by MWD and CWA.

III. Notice to Customers

Article XIII D, Section 6 of the California Constitution imposes procedural and substantive requirements on new or increased fees or charges for on-going water service. Proposition 218 amended this Article and Article XIII C to add provisions requiring that a public



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Members of the Board of Directors and
Mark Watton, General Manager
April 28, 2009
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agency proposing to impose a new fee or increase an existing property-related fee or charge must provide written notice by mail to the record owner of each parcel upon which the fee or charge will be imposed. The notice must contain certain information respecting the proposed fee or charge and the date, time and location the public agency will conduct its public hearing on the proposed fee or charge. Article XIII D, section 6(a)(2) further requires that the public hearing be held not less than 45 days after the mailing of the notice. If at the conclusion of the public hearing the public agency receives written protests against the imposition of the proposed fee or charge from a majority of the affected property owners, the fee or charge may not be imposed. Ongoing water rates paid by water customers are "property-related" fees and thus subject to Proposition 218's substantive and procedural requirements. *See Howard Jarvis Taxpayers Assn. v. City of Fresno*, 127 Cal. App. 4th 914. Thus, normally, Otay's increased water rates would be subject to Proposition 218's notice and hearing requirements.

However, in certain circumstances, *these requirements may be waived*. Specifically, where implementing any adjustment made pursuant to a schedule of fees or charges as authorized pursuant to California Government Code section 53756, *an agency is not required to follow the notice provisions of California Constitution article XIII D, section 6*. Thus, the 45 day notice requirements of Prop 218 do not have to be followed. Otay must, however, provide written notice of any adjustment pursuant to a schedule not less than 30 days prior to the effective date of the adjustment. Such notice may be given, as provided in California Government Code section 53755(a), by including it in Otay's regular billing statement for the fee or charge or by any other mailing to the address to which Otay customarily mails the billing statement for the fee or charge.

IV. Conclusion

Otay is facing an increase in wholesale water costs as well as a decrease in wholesale water allocation. In order to effectively manage this increase in costs and decrease in water, Otay, among other things, must provide for increases to its water rates and charges. Pursuant to the provision of the California Government Code, section 53756, Otay may adopt up to a five-year schedule of rates of charges. Subject to the notice requirements specified above, the schedule may provide for automatic adjustments to pass through MWD and CWA increases or decreases and inflationary adjustments may also be implemented.

Sincerely,



Yuri A. Calderon
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