

MORRO BAY WATER RECLAMATION FACILITY

BLUE RIBBON COMMISSION

June 21, 2018

Prepared for the City of Morro Bay by Blue Ribbon Commission Members:

 6/21/2018
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I. INTRODUCTION

Morro Bay City Manager, Scott Collins, appointed four citizens to a Blue Ribbon Commission (BRC) on April 23, 2018 to evaluate the costs and potential user rate increases associated with the Water Reclamation Facility (WRF). Members of the Blue Ribbon Commission are Homer Alexander, John Martin, Joan Solu, and Barbara Spagnola. Mr. Alexander is a former chairperson of the City's Measure Q Citizens Oversight Committee and a retired small business owner. Mr. Martin is a current member of the Citizens Finance Advisory Committee and is a certified public finance officer who brings over twenty-three years of public sector management experience, including eight years as general manager of a water district. Ms. Solu is a former chairperson of the Tourism Business Improvement District Board, who has worked in the hotel industry since 1989, owning and operating several motels in Morro Bay. Ms. Spagnola is chairperson of the Citizens Finance Advisory Committee and a member of the WRF Citizens Advisory Committee, recently retired after spending over twenty-five years in IT management, contract negotiations, and budgeting.

The mission statement for the Blue Ribbon Commission is: "The WRF Blue Ribbon Commission is committed to independently evaluating the costs of the major components of the WRF program and water and sewer capital project needs and provide a recommendation to the City Manager for equitable and reasonable customer rates to pay for those needs."

The Commission met eight times with City staff (Scott Collins, City Manager, Rob Livick, Public Works Director, Jennifer Callaway, Finance Director, and Joe Mueller, Utility Manager) along with Eric Casares of Carollo Engineers, Program Manager and Alex Handlers of Bartle & Wells Associates. Mr. Handlers is a Public Financial Advisor who is helping the City establish the new water and sewer rates. The Commission also met independently several times. The objective of these meetings was to gather and analyze information regarding cost components of the WRF project and recent draft plans for current and future water and sewer non WRF related capital expenses, suggest cost reduction alternatives for both the Water and Sewer Funds, evaluate varying scenarios for financing, and determine the impact of all of the above on future user water and sewer rates. The Commission consistently challenged the City staff and Program Manager on every component of the cost structure used to develop the new rates.

The Commission reviewed and commented on four working drafts of the "Financial & Rate Analysis for a New Water Reclamation Facility" prepared by Bartle Wells Associates. Key points focused in our discussions included challenging the debt coverage ratio assumptions, contingency assumptions, and the accounting separation of water and sewer charges. A summary of the questions and comments raised by the

Commission members, and the associated responses from City staff and consultants, is attached to this report as Appendices A and B. This information in Appendix A and Appendix B is current as of the date of this report and was used for the recommendations provided later in this report by the Blue Ribbon Commission.

II. DISCUSSION OF ISSUES

A. Capital Costs

The Commission recommended to the City that only the following criteria be used for selecting the Capital Cost projects, unrelated to the new WRF, that should be completed:

1. Any project that if not completed could have an immediate adverse effect on the Health and Safety of the Community must be completed.
2. Projects that are absolutely needed to insure an adequate water supply.
3. Projects that are integral to the new Treatment Plant.
4. Projects to replace infrastructure that might fail in the next five years.

The Commission focused a good portion of meeting discussing the recently published draft of the OneWater Plan which addressed immediate and long-term infrastructure needs for the City owned Water and Sewer Utilities that are not related to the new Water Reclamation Facility. The Plan was prepared by a team from Carollo Engineers. These projects will be funded for the next five years by the free cash flow that the Water and Sewer Revenue Funds generate. The projected costs in the report are engineering estimates. They include the cost of construction, a 30% contingency, 10% for engineering, 10% for Construction Management and 7.5% for Project Administration. The cost figures in the report are in today's dollars.

Fire Suppression and the replacement of the Nutmeg water tank constitute a significant portion of the costs in the Water Fund in the next five years. There are certain sections of Morro Bay where the Fire hydrants test below a standard of 20 psi Maximum Day Demand (MDD). The OneWater plan recommends that the pipes in these sections be replaced with pipes that are a larger diameter to ensure that there is more than adequate water capacity for firefighting.

Further, the Commission discussed the need for the City to negotiate for purchase or a long term (50 year) lease for the Nutmeg site and or any space needed to secure the capital improvement needs for the Nutmeg project.

The replacement of the Nutmeg Water Storage Tank is necessary because the existing capacity is not sufficient to supply the Nutmeg zone with consistent MDD. Initially this project was planned to start in the fiscal year 2019-20. After a lengthy discussion it was agreed that the expense be spread over a number of years because there are logistical issues in reaching the tank, along with potential permitting delays.

Other major expenses in the Water Fund include upgrades to the control systems at the brackish water/desal plant and increasing the capacity of the fill line to the Nutmeg water storage tank.

A significant portion of the projected capital costs for Sewer infrastructure improvements in the next five years is the replacement of the gravity main on Main St. that runs from San Joaquin Street to Atascadero Road with pipe that has a capacity that is at least 50% larger. The gravity main along Beachcomber from Toro Lane to Java is scheduled for rehabilitation or replacement. Ongoing, there are capital projects to reduce the amount of infiltration and intrusion (INI) which includes replacing certain pipes that have been identified as the cause of significant INI and also replacing caps and manholes covers.

B. Billing Options for Water and Sewer Charges

The Commission discussed methods that could be utilized for the collection and payment of the capital costs of the proposed new Water Reclamation Facility (WRF). The City currently sends all ratepayers a monthly bill for both the water and sewer services. If the capital costs associated with the new treatment plant were to be included in the combined water and sewer utility bills, the monthly amount will increase significantly for all ratepayers.

An alternate method of recouping a portion of the combined water and sewer capital costs would be to include these costs on the County property tax roll, as opposed to the monthly utility bill. It is our understanding that this process for collection of infrastructure project capital costs is used by many local agencies. With this method, payment responsibility for the water and sewer capital costs (\$41 per month as of the date of this report) shifts from the rate payer to the parcel property owner.

Both of the above methods of cost recovery have advantages and disadvantages. The current monthly utility billing process is familiar to everyone and illustrates a direct connection from the cost of the new plant to the ratepayer receiving the service. This method also provides the City timely receipt of water and sewer revenues, since the billing is monthly. Ratepayers who are also property owners do not have to save monthly for a semiannual property tax bill. Billing monthly will also provide more funds for the Utility Discount Program. The major disadvantage of monthly utility bills is the impact such significant increases may have on the low-income ratepayers, and the potential resulting delinquencies which the City has to follow through to collect.

Should the capital cost of the WRF be transferred to the property tax rolls, the payment responsibility would accordingly be transferred from the ratepayer to the property owner. While the overall total costs for the WRF would remain the same, the visibility changes. Additionally, the property owners who are landlords may or may not immediately pass on all of the increased costs to their tenants. Since the completion of a major infrastructure project benefits property owners, it may be appropriate to recover these costs via the property tax rolls. A disadvantage of the property tax method of collection is that there is no existing utility discount program offered for property tax charges.

San Luis Obispo participates in the Teeter Plan, which means the City receives 100% of all assessments placed on the property tax rolls for collection, regardless of any actual delinquencies. The County Assessor's office handles the delinquencies, and retains any penalties collected as well. Thus, the City does not have to collect on delinquent charges for the sewer capital cost. A final advantage of utilizing the property tax rolls for the WRF cost is that there would be a visible termination of the assessment, typically 30 years or whatever time period the capital costs are financed.

Finally, both of the above methods of cost recovery could also be applied to the water service provided by the City. The Commission is not recommending one method over the other, but merely addressing the pros and cons of both methods for consideration and implementation by our elected leaders.

C. Cost Reduction

At each meeting, the Commission challenged the City staff, Program Manager and Rate Advisor on every revenue and expense line item in the cash flow projections used to develop the new rates for the WRF project. All of these ideas were presented during the meetings held with City staff and external personnel currently working with the City on the WRF.

Regarding Table 1 from the "Financial & Rate Analysis for a New Water Reclamation Facility" dated June 21, 2018, the Commission discussed adding a column entitled "Project Reserves," which are placeholder estimates for additional project funding requirements (e.g. outside project scope) with funding subject to City control. The Commission argued successfully to reduce this amount. The current Program manager, Mr. Eric Casares, was uncomfortable totally eliminating it, because the original Request for Proposal (bridging documents) was not prepared by Carollo Engineers. As negotiations with Filanc/Black & Veatch progress, the expense in this column of Table 1 may be reduced.

The Commission questioned whether the new and more automated treatment plant would require the same number of employees as the existing plant, and what reduction in headcount could be anticipated from cross training plant employees. There are currently two vacant authorized positions within the water department. The City's Utility Manager, Mr. Joe Mueller, anticipates not filling these positions resulting in the permanent reduction of these positions in future years.

The Commission also proposed the design of the new operations building be revisited and possibly scaled down to reduce costs. Combining the operations and maintenance buildings was discussed, but the City's Utility Manager presented a number of good reasons to keep them separate. However, he did indicate in the negotiations with the Design/Build team he expected the costs of the operations building to be reduced (apparently the architectural design of the building may be more elaborate than

necessary). We also discussed removing the \$ 1.5 million cost for demolition of the existing plant, which was done. Finally, the Commission and the project team reduced the cash funded water and sewer infrastructure capital costs over the first five years by approximately \$ 3 million.

The Commission discussed several additional items for potential rate reduction:

- Prioritization for the capital projects identified in the OneWater Plan.
- Questioned the feasibility of projecting savings from a solar leaseback program.
- The Commission recommended that the feasibility of consolidating the pipes to the new plant into a single trench be investigated.
- Scrutinized the fund reserve forecast in the cash flow statements to more closely align with the Council's newly adopted reserve policy. This action has resulted in lower rates.

Many of the ideas presented by the Commission members along with the City staff's responses are documented in Appendices A and B.

D. Financing Options

The initial plan to finance all of the components of the new Water Reclamation Facility project is coming from four sources. They are: (i) accumulated cash; (ii) a ten-year planning loan at a rate of 1.70% from the Clean Water State Revolving Fund Financing Program (SRF) in the amount of \$10.3M; (iii) a thirty-five-year loan at an estimated rate of 3.25% from the Federal EPA's Water Infrastructure Finance & Innovation Act (WIFIA) in the amount of \$60.2M; and (iv) a thirty-year loan at an estimated rate of 4.75%, financed by issuing bonds in the amount of \$28.9M. The Bonds will be structured so in the first ten years the City will only be repaying interest. When matched with the ten-year amortization term of the SRF planning loan the total debt service payments remain constant for the first thirty years.

Because the City does not have a letter of commitment from the managers of the State Revolving Loan program the new rates are being calculated using the \$28.9M of bond financing. The City has submitted preliminary application to SRF. When the EIR is certified later this summer the City will be in a position to submit a complete application. It is estimated that the application review process may require up to eighteen months.

The City Staff is optimistic that they will receive a thirty-year SRF loan at an estimated rate of 2.2% for the balance of the principal that is required beyond the WIFIA loan. If that occurs the SRF loan would replace the \$28.9M of bond financing. Eliminating the Bond financing would reduce the total annual debt service expenses, which would result in an estimated reduction in the rates of about \$6 per month. In addition to the reduction

in interest rates, the \$10.3M SRF planning loan will be rolled into a thirty-year SRF loan which would have a positive impact on lowering the annual debt service payments.

If the City is able to secure SRF financing then the elected officials would have the option of either slightly reducing the monthly base water and sewer rates or to accelerate water and sewer infrastructure improvement projects.

E. Conveyance to and from the Plant (Pipes and Lift Stations)

The route of the force main from the existing Atascadero Road Treatment Plant to the new Water Reclamation Facility on South Bay Boulevard will travel along or under the bike/pedestrian path (runs just to the east of the Morro Bay Power Plant to the intersections of Quintana and Main). The force main would then continue south on Quintana to South Bay Boulevard then north to the new plant. In addition to the force main the trench will also include a pipe for the brine discharge and heavy wet weather processed flows to the City's Outfall to the Ocean. The trench will also include a potable water line for fire suppression at the plant.

The design of the route for the pipe to transport the recycled water to the injection well fields in the Morro Valley has not been determined. The two routes that are being considered are on either side of Highway 1. There is a possibility that if the westside route is chosen the pipe to the injection wells could be placed in the same trench as the force main, which would lower the estimated costs and therefore possibly have a positive impact on rates. However, there are concerns that due to other underground utilities in the same area it may not be possible to increase the size of the trench to accommodate the additional pipe.

F. Billing

The Commission discussed the need for the Water and Sewer billing process to be clarified for all rate payers. There is concern by the City that the current bill design is not adequate for the needs of the community. Similar concerns were expressed by the Commission. It was noted that largely, the community refers to the current bill as the "Water Bill" based on the format provided. The City is currently in the process of updating its billing to reflect a clearer, more easily readable water and sewer bill for the rate payer. The Commission suggested that bills should reflect the user category i.e. residential or commercial, with a reference to strength class for sewer charges for the commercial user. Additionally, the bill should reference where the rate tiers and rate structure can be found on the City web site along with any scheduled increases. Further, the Commission believed that it would be good practice for the City to "Audit" the commercial bills against the commercial business licenses and/or commercial public building use to ensure that rate payers are being classified correctly. Many buildings

have changed in use over time therefore there is opportunity for the City to implement best practices to maintain billing integrity. It was also suggested that any future scheduled increases have a notice of said increase included in the water and sewer bill 30 days prior to the increase occurring.

G. Water Independence and the State Water Project (SWP)

Since state water is a major component of the water rates, the Commission spent considerable time analyzing present and future state water impacts to the rate structure. One of the community goals is to achieve local water supply independence through the complete recycling of wastewater by the proposed advanced treatment component of the WRF and the associated indirect potable reuse (IPR) project (off-site improvements). While this is a worthy goal, the Commission concludes that the benefits from this achievement will be limited for the duration of the SWP contract, which expires in 2038. This conclusion is based on the following findings:

- Costs for SWP water are largely fixed and the City will not be able to escape paying them regardless of how much water is delivered.
- Both groundwater basins available to the City are contaminated with nitrates and cannot be delivered directly into the potable water system without treatment.
- Treating the local groundwater is more expensive than the variable charges for SWP water.
- The City has contingent water supplies available.

The City is under contract with the San Luis Obispo Flood Control and Water Conservation District (SLOFC) for its SWP water supply, which comes to the City already treated by the Central Coast Water Authority (CCWA). The City is billed for five different types of charges related to SWP water: (1) Department of Water Resources (DWR) charges, (2) drought buffer, (3) CCWA bonds (Chorro pipeline), (4) CCWA fixed O&M and (5) CCWA variable O&M. All but the last of these charges are fixed. Annually, the City pays approximately \$2.2 million in total for SWP water, with less than \$80,000 in the form of variable charges. So, the remaining \$2.1 million is due and payable even if no water is delivered. The drought buffer, which provides the City additional SWP water during a drought, is under a separate contract and the City can decline this on an annual basis, which would save about \$260,000 per year. Final payment on the CCWA bonds will occur in fiscal year 2021/22, which will reduce fixed costs by \$670,000 per year. So, beginning in fiscal year 2022/23, the City will have annual SWP fixed costs of \$1.2 million (2018 dollars) which will persist until 2038.

Over the past five years, the State Water Project provided 92% of the City's water supply, with the remaining 8% coming from wells in the Morro Valley Groundwater Basin, which is contaminated with nitrates. Its groundwater must be processed through the City's Brackish Water Reverse Osmosis (BWRO) facility. The BWRO has an

operating capacity of 450 GPM, a peak capacity of 900 GPM and delivers 80% of its input water to the potable water system (20% to waste). The City has 581 acre-feet per year (AFY) of water rights in the Morro Basin, which translates to 465 AFY into the system after BWRO treatment. The City also has 1,142 AFY of water rights in the Chorro Valley Groundwater Basin, but it currently lacks a method to treat that water to meet state and federal water quality standards. So, for now, the City effectively has no water available from that source.

The BWRO has sufficient capacity to treat all of the City's groundwater available from Morro Basin, but it will need to be expanded to treat additional water introduced through IPR. The City commissioned GSI Water Solutions to create a groundwater model, which "indicates that it may be possible to achieve the 825 AFY injection goal." Further field studies will be required to test transport times to meet state water quality standards. If IPR is permitted, it is unknown how much of the 825 AFY will become available in the City's wells, as that will be determined by the degree of saltwater intrusion into the well field. Assuming that all of the water will be available, the 825 AFY will be processed by the BWRO into 660 AFY to the potable water system, resulting in 1,125 AFY when added to the Morro Basin supply.

City staff and engineers expressed that the introduction of pure recycled water could clean the Morro Basin over time and that eventually the groundwater will not need to be processed by BWRO. However, the level of nitrate contamination (as much as three times the maximum contaminant level in one well) presents a challenge to this goal. Moreover, the quantity of water introduced through IPR will likely be too small to impact a basin with a storage capacity of up to 33,000 acre-feet (DWR Basin 3-41 Report). So, it appears that all of the water from the WRF that will be injected into the Morro Basin will need to be processed through an expanded BWRO at a much higher cost than taking delivery of SWP water and paying the relatively small variable charge. Therefore, the City is aware that until 2038, it is likely that the most economical way to deal with the water recycled by the WRF will be to inject it into the ground and leave it there.

In addition to its 1,313 AFY of SWP contract water, the City has contracted for a drought buffer of 174% of that amount. In addition, when the City doesn't take its full SWP annual supply, it is stored in the San Luis Reservoir and can be taken in future years. Moreover, the SLOFC can "loan" the City some of its SWP supply that can be paid back later. These provisions enabled the City to survive the most severe drought in California's history. In 2014, the SWP's allocation was only 5%, which would have provided only 180 AF under the City's drought buffer provision, yet the City took delivery of 1,214 AF that year. The following year (2015), the SWP allocation was only 20%, which should have provided only 720 AF, yet the City took delivery of 1,094 AF. The SWP, while unreliable, has been rendered much more reliable by the wise actions already taken by the City. Finally, in the past, the City has established emergency

water supply agreements with the California Men's Colony, Whale Rock and Morro Bay Power Plant to address the unreliability of the SWP.

The Commission concludes that water made available by the WRF should be viewed as an insurance policy rather than as a primary source of water. In the event that there is a catastrophic failure of the SWP south of the San Luis Reservoir (Los Banos), the City could tap the banked recycled water during the emergency. However, during normal times, even during severe droughts, the SWP would provide the lowest-cost water available to the City.

III. BLUE RIBBON COMMISSION RECOMMENDATIONS

The Blue Ribbon Commission has completed their analysis of all cost components of the WRF and the impact of these current and future costs on the water and sewer rates necessary to support this project.

The City of Morro Bay "Financial & Rate Analysis for a New Water Reclamation Facility with WIFIA & Bond Financing Draft" of 06/21/2018 prepared by Bartle Wells Associates proposes a residential combined water and sewer WRF facility surcharge of \$41.00 per month to be added to the already adopted rates as of July 1, 2019. As a result, the total rate increase for an average residential rate payer would be approximately 28%. Based on the information provided to the Commission for analysis at the time of this report, the Commission considers the City's rate proposal to be reasonable.

Further the Commission agrees that if the City Staff and Eric Casares, Program Manager were given additional time to begin negotiations with Filanc/Black & Veatch the process could potentially generate additional cost reductions for the WRF which could benefit rate payers. Therefore, the Blue Ribbon Commission suggests that the scheduled City Council meeting of July 10, 2018 to approve the new water and sewer rates be postponed to August 14, 2018 to provide City staff and the Program Manager sufficient time to negotiate any potential additional cost savings.

The Commission also recommends City Council authorize a contract to GSI Water Solutions to proceed with the field work in the Morro Valley to determine the feasibility of ground injection. The results of their analysis have the potential of reducing the advanced treatment processes which could further lower costs.

Regarding the monthly utility billing, it is recommended the WRF surcharge for the new Water Reclamation Facility should appear on the monthly bill as a separate line item.

The Commission requested that Bartle Wells Associates (BWA), the City's rate advisor, provide a rate analysis for the WRF without reclamation, financed at the higher rates for bonds issued by the City. Since the Commission has not received that analysis, we have no comments nor recommendation to offer.

APPENDIX A

Blue Ribbon Commission Questions and Answers

Submitted May 31, 2018

The following questions have been composed by the Blue-Ribbon Commissioners as a group. The questions are divided into the 3 sections based on the project and the goals of the commission as discussed at our third meeting:

Water and Sewer Combined (WS)

Water Only (W)

Sewer Only (S)

Each section is further divided into sub categories that contain questions, ideas and considerations for City Staff and the various firms hired to produce a competitive project that meets the communities needs and is financially responsible.

We believe the answers to our questions will begin the process of providing the information necessary for the Commission to properly evaluate the proposed new sewer and water rates and subsequently make appropriate recommendations.

The name of the individual (s) who supplied the answers is to the right of the heading for each question or group of questions. The answeres were supplied in writing and viewed at our June 6th meeting.

WATER AND SEWER

WS-I. General – Answer - Casares/Handlers

- A. Splitting costs accurately and equitably between **Water and Sewer** that are not easily defined (i.e. headworks-defined vs. site prep-not defined) will be key to determining accurate rates. This work must be done in order to provide information to the public for a 218 vote.
 1. Who will be determining ratio? - **1. Carollo as the Program Manager will be determining the split between the Water and Sewer. Costs attributed to both water and sewer will be apportioned as a ratio between water and sewer.**
 2. When will this work be done? **Ongoing.**

3. Will your rate study provide information comparing the proposed rates with EPA's and CalEPA's affordability index for water? We can include whatever is desired. However, the rates will need to recover the costs of service and in some cases, that may result in rates that exceed an index.

WS-II. Finance – Answer -Callaway/Handlers

- A. Considering the projects will be financed with, the ten-year planning loan, WIFIA and SRF loans
 1. Who is going to be responsible for blending loan interest rates together to determine the annual debt service? Alex Handlers from Bartle Wells Associates (BWA) is modeling the debt financing. He is a Certified Independent Professional Municipal Advisor with extensive experience structuring debt service and serving as financial advisor on issuance of bonds, COPs, bank loans, lines of credit, State Revolving Fund Loans, and other types of financing. The interest rates will not be “blended”, instead each component of the financing will be modeled independently.
 2. Who will be responsible for forecasting the existing cash that is available in both funds? The City's finance department.
 3. What are reserve requirements for the different loans? The reserve requirements for each financing will be modeled independently based on the requirements of each source of financing. For example, a) State Revolving Funds typically require a one-year debt service reserve fund to be funded at least 90 days prior to project completion, b) the reserve requirement for bonds/COPs may need to be cash funded or can potentially be satisfied by a reserve surety bond issued by a bond insurance company, c) the reserve requirement for WIFIA is somewhat negotiable depending on credit quality.
 - i. If the reserve requirements are different who will blend them?
 4. How will the City control the amount of principle to be borrowed from either the EPA or SRF loans if one of the lenders has significantly more favorable terms? Who determines which loan gets priority/majority of the debt?

From the City's perspective, the goal will be to maximize the lowest-cost financing (in this case, first maximize SRF, then maximize WIFIA). However, we may not have this luxury at the end of the day. Also note that WIFIA will only fund up to 49% of the project cost and SRF has not yet provided any funding.

WS-III. Personnel Costs – Answer - Callaway/Mueller

- A. Between the three accounting entities--Water, Collections and Treatment--- there has been significant turnover of staff in the last three years. Most of the new hires are at the beginning of their step increase process and additionally most of them are at tier 3 CALPERS rates.
1. We recommend that the City calculate each individual employee's actual salary and benefits separately for each year over the next five years. The City should use 2018 wages and benefits for accurate measurement. The sum of those numbers should be included in the rate study vs. an arbitrary percentage annual increase. The total 2017-18 budget for personnel is \$2.475M.... not an insignificant number.
- B. Will the new automated plant really need the same number of employees as the existing plant? Over the past two years the existing plant and collections staff have been anticipating an updated facility by planning and par-paring staffing and operations plans. By taking advantage of the efficiency gained by shared department staffing and the anticipation of a new facility two FTE positions that became vacant where not filled.
1. How many employees are expected to be cross trained- All 15 water, wastewater, and collections staff will have the opportunity to cross train, initially cross training will be focused on the 11 operations staff members with the remaining 4 lead and supervisor positions focusing on their specialized areas.
 2. How many are expected to be phased out through natural attrition such as retirement over the next 5 years? As stated in #2(i) two FTE's where phases out over this past year, current FTE levels are what is anticipated for the operation of current and future facilities.

WS-IV. Buildout Calculations – Answer - Handlers

- A. Will the projected numbers that will be used for new customers correspond with the Community Development Department buildout projections? BWA strongly recommends that any financial projections be based on conservative growth assumptions. Revenues from projected growth typically have little impact in the bigger financial picture and are not considered a reliable recurring revenue source for debt repayment.
- B. Who is calculating the future impact fees? City's water and sewer impact fees. A few years ago, BWA conducted some initial analysis indicating that the water and sewer impact fees could be increased. Higher impact fees may help offset the need for future rate increases to a small degree, but would only have minimal impact on proposed rate increases at this time as the adopted rates generally

need to be adequate to support debt repayment and associated financial covenants assuming minimal to no future growth.

WS-V. Interest Rates – Answer - Handlers

- A. Was the interest rate for the ten-year planning loan locked in when the loan was secured? If so what was the rate? The SRF planning loan has a 1.7% rate and a preliminary repayment schedule that starts in Fiscal Year 2020/21. However, it may be possible to roll repayment into a longer-term 30-year SRF Loan. Alternatively, it may be possible to structure the WIFIA loan or potential bonds around the debt repayment schedule for the 10-year planning loan to result in level annual debt service in future years (as opposed to elevated debt repayment for 10 years).
- B. How is the WIFIA interest rate going to be determined for the debt service calculation? WIFIA interest rates are based on the US Treasury Department's rate for State & Local Government Securities (SLGS rate) corresponding with the Average Weighted Maturity of the loan. The rate is locked in when the WIFIA loan agreement is finalized. The rate fluctuates daily and is currently right around 3% for a loan with an Average Weighted Maturity anywhere from 20-30 years.

WS-VI. Capital Projects Prioritization – Answer - Casares

- A. We believe the capital projects identified in the first five years in the OneWater Plan should be prioritized in the following order:
1. Any project that if not completed could have an immediate adverse effect on the Health and Safety of the Community must be completed.
 2. Projects that are absolutely needed to insure an adequate water supply.
 3. Projects that are integral to the new Treatment Plant
 4. Projects to replace infrastructure that might fail in the next five years

We are working directly with BWA to move as much of the CIP as possible later in the planning horizon. We agree with your recommendations and are using them to aid in this re-prioritization. In addition, the criteria you are using, we are also considering:

1. Projects that would reasonably be constructed together (i.e., tank as well as pipeline needed to fill the tank).
2. Sequencing (i.e., upsizing gravity sewer lines starting at the downstream end).

- B. Other projects should be pushed off into the second five-year period or even into the second ten years. [Noted. We will be trying to maintain a consistent spend for capital projects throughout the period.](#)

WATER

W-I. General – Answer - Casaras/Handlers

1. Will Morro Bay's 2015 Urban Water Management Plan inform your water demand forecast in your 2018 rate study? [It may potentially provide some useful information for a water rate study. However, the demand projections in the 2015 UWMP were developed for a completely different purpose of evaluating water supply needs, etc. I do not recommend using outdated demand projections for a water rate study, but instead would recommend using slightly conservative demand estimates based on recent historical water use. If water use and water sales revenues were to significantly increase in upcoming years, then that would potentially offset the need for future rate increases.](#)
2. Will your rate study include a robust cost analysis (\$/AF) of the City's many water sources, including water delivered through the proposed advanced treatment / indirect potable reuse project? [The OneWater Plan includes a robust analysis of the costs associated with various water supply options including several variations of IPR.](#)
3. Is the water reliability analysis in the 2015 UWMP current for the City? If not, have you been assigned to write an update? [The UWMP plays a specific role and the information regarding the reliability of the City's water supply has been updated in the OneWater Plan.](#)

W-II. Revenue- Answer - Handlers

- A. Interest Income—What rate will be used to calculate future income? [BWA is currently assuming an interest rate of 1.5% through year 5, with a future assumed rate of 2.0% in outer years. LAIF's most recently quarterly yield as of March 2018 was 1.51%. Please note that interest earnings are only a very small component of utility revenues, most of the revenues are generated by rate revenues.](#)
- B. System Capacity Charge (Meter Size) --- A significant portion of the City's water CIP is for "Fire Flow Improvements." How will these costs be incorporated into your rate recommendation? Would it make sense to add a safety surcharge to every bill to cover the cost of Fire suppression and therefore lower the base charge? [There are a number of ways of apportioning costs for fire flow](#)

improvements that can be evaluated. I am typically not a fan of trying to break out such costs and separately reallocating, but that is always a possibility.

1. Does the Glendale decision affect this? I am of the understanding that there has not yet been any court decision but we can incorporate any new legal requirements as they are known.

- C. We recognize that this is questionable but charges for fire suppression are something that the community might find appealing and could more readily support. Instead of trying to break out a small component of the charge for fire suppression (or any other factor) in the rates, the issue of fire suppression could be discussed as one of the factors impacting rates.

W-III. Expenses – Answer - Casares

- A. What are the estimated electricity charges for the new advanced treatment/ RO for the new plant? Based on the anticipated, selected proposer, the estimated electrical cost is \$190,000 or \$16,000 per month (first year of operation in 2022 presented in 2018 dollars).
- B. Is it possible to project savings from the solar lease back program that Mr. Livick has been referring to? If so can the calculated savings be used to lower the new plant's O&M costs that will be used to calculate the new rates? We do anticipate potential cost savings from debt forgiveness through the SWRCB SRF Green Water Reclamation debt forgiveness and through savings in energy costs. Unfortunately, it is too early in the process to identify the costs at this point and use those savings in the rate analysis.

W-IV. State Water – Answer - Callaway

- A. Who is going to determine the base year for the pass-through charges from DWR and the O&M costs from the CCWA? State Water costs are based on the latest year with data available with an inflation of 5% for O&M costs annually.
- B. What is the exact date of the last bond payment to the CCWA for the Chorro Valley Turnout? June 1, 2021 (last debt service payment is for FY 2021/2022 and the payment is made on June 1st).

W-V. Specific Capital Projects – Answer - Casares

- A. Nutmeg Water Tank

1. The replacement should not take place until

- i. The land can be purchased and annexed into the City or
- ii. A new lease for the land the tank will occupy is signed and at a minimum the new lease should be as long as the useful life of the tank.

Capital cost of the tank should be accrued over a three-year period in anticipation of the community objections and permitting delays. [Noted. The Nutmeg Tank project will be pushed-out in the CIP in order to provide sufficient time for these activities to occur.](#)

SEWER

S-I. Revenue – Answer - Handlers

A. Impact Fees-Fee projection should match the Community Development Departments projections to buildout. [BWA recommends using conservative growth projections for financial planning and rate setting, particularly since the City's creditworthiness will be a key component for securing financing.](#)

S-II. Expenses – Answer - Mueller/Livick

- A. What are the existing electric fees for the existing plant? [Current plant electric expenses to date for FY 17/18 average approximately \\$12,600 per month.](#)
- B. Also, see Water Re: Solar lease back. **(W-II. B and B-1.)** [We do anticipate potential cost savings from debt forgiveness through the SWRCB SRF Green Water Reclamation debt forgiveness and through savings in energy costs. Unfortunately, it is too early in the process to identify the costs at this point and use those savings in the rate analysis.](#)

S-III. General – Answer - Casares

A. Cayucos

[Has anyone talked to Rick Koons or Robert Enns recently to try and pin them down on the quarter and year they anticipate processing their own waste water? I have spoken to my contacts at WSC \(SLO Engineering Firm that is working with the Cayucos\) and are indicating that the plant should go online in 2020. They are not providing any additional information regarding timing at this time.](#)

S-IV. Existing Plant – Answer - Mueller/Livick

A. Are there any major maintenance and/or major repairs that are beyond normal O&M expenses planned for the Atascadero Road plant between now and

the time the new plant comes on line? No, short of any unforeseen failures, the current operations philosophy of the existing plant is normal routine maintenance and repairs not major rebuilds and/or replacements.

B. Decommissioning and Demolition of the existing plant

1. Consideration should be given to deferring this expense until the second five years. For several reasons:

i. Resolving the issue with the Cayucos Sanitary District on the division of expenses might be contentious and possibly involve litigation.

ii. The City's new General Plan appears to have designated the site the current plant sits on as recreation/open space, therefore waiting a couple of years to demo the plant will not have an adverse effect on any potential new City revenue. Also, in all likelihood the Coastal Commission will not allow any permanent structure built on the site.

Per previous discussion, the City has attractive pricing from the Design Build (DB) proposers for the decommissioning and demolition of the site. Staff believes it is prudent include it as part of the project and use low-interest financing for this aspect of the work. It may be beneficial to remove this from the DB team's scope and bid the work to a local contractor, but still keep it under the program.

APPENDIX B

Blue Ribbon Commission Questions and Answers

Submitted June 18, 2018

Questions to and Answers from Alex Handlers, Rate Advisor:

1. Will Table 2 be modified to show a 5% WRF contingency in the amount of \$3,445,000 on a separate line described as "unanticipated change orders / scope changes" or some other appropriate description?

We have modified the costs based on removal of the demolition from the project and other modifications. The total project cost estimate is now approximately \$126M. I have performed a detailed cost accounting to more accurately determine project soft costs (i.e., construction management, program management, design, permitting, etc.) and the remaining project costs are \$121M (expenditures starting FY 18/19 through FY 21/22). This will be the number used to determine rates (\$121M).

2. Can Table 9 be modified to show only sewer-related items, similar to Table 11, but with all of the detail of Table 9? During our last meeting we asked about the potential of reducing Pay-Go CIP and were told that it had to be \$1,350,000 because of the 1.25 coverage ratio. But if Table 9 is constructed with only sewer-related items, the coverage would be less than \$1 million. Using the figures from Table 11, it appears that the revenue requirement could be reduced by about \$400,000, which would leave about \$1 million annually for Pay-Go capital.

Yes...already done.

3. Will you be presenting a similar table for water? Table 15 lacks the detail that Table 9 contains.

Yes...already done. I looked back at the pdf and see that I somehow missed including the Water Cash Flow Projections in the prior pdf that I had circulated.

4. Table 15 water cost allocation includes the O&M cost for advanced treatment & recycling from Table 14. Since that is a variable operating cost, why is it being included in the WRF capital cost recovery rate calculation? Should that cost be covered by the existing water volume charges, especially considering that operation won't begin for several years?

It is not...the prior Table 15 had only indicated the water utility's funding allocations related to the WRF and future water recycling.

5. Table 15 shows a 70/30 split between residential and commercial customers. What is the source of this split? Does the City have a more precise split based on their utility billing history?

Yes...that was my preliminary estimate for purposes of determining a proportionate allocation of cost-recovery between residential and commercial/non-residential accounts. I have since acquired data for the past 2+ years and have modified the allocation based on usage over the most recent 12-month period.

6. Table 15 calculates an SFR monthly rate of \$23.97 in base year 2022/23, the first full year of debt service payments. What is the nexus between that calculated figure and your recommendation of \$25? Is it simply rounding up?

I think that may have been the case in the prior draft you are referring to.

7. Table 15 calculates a water volume charge for commercial customers to recover the water portion of the WRF debt service. Since they already pay a water volume charge per the City's increasing block rate structure, how will this be incorporated and shown on the water bill? As an alternative, what form would a fixed charge take?

This could be treated as a separate line item. Due to the non-homogeneity of commercial accounts, I would generally recommend a volumetric charge for commercial. I would be happy to discuss in more detail.

Questions to and Answers from Eric Casares, Program Manager:

8. Could you provide the coverage ratio requirements for WIFIA and SRF?

Answer not available

9. Do you have any additional information about the feasibility of locating more pipelines in Quintana Road?

We do not have any additional information at this time regarding the potential for routing additional utilities in Quintana. At this time, we believe the best approach is to assume the separate routing of the purified (i.e., IPR) water line.

10. Will you and Alex be providing a rate analysis for bond financing of the WRF without the recycling portion?

Yes. We have a separate cost estimate for the non-IPR project. The total project cost is \$105M with \$100M left in the program (i.e., \$100M is what will go into the rate study).

11. Will demolition of the existing WWTP be removed from the project costs?

Yes, this component of the project has been removed. The recommendation is to keep it as a bid "add alternate" and only have the work done by the design-build contractor if budget permits.

12. Will the WRF use recycled water as process water? Or will potable water be required?

The WRF will use recycled water for process water, but will still require potable water for drinking, fire protection, locker room facilities.

Questions to and Answers from Jennifer Callaway, City Finance Director:

13. Could you send a copy of the CCWA contract provision re: the SWP coverage ratio requirement? What is the denominator of that calculation? Is it the full amount of annual payments to CCWA or some portion thereof?

Attached is the Official Statement from CCWA's most recent Bond refunding. Beginning at the bottom of page ii, under the heading "Rate Covenants", it reads:

"Each San Luis Obispo Purveyor or Purchaser has agreed to fix, prescribe and collect rates and charges in connection with its water system which will be at least sufficient to yield each fiscal year net water system revenues equal to 125% of the sum of the Contract Payments required to be made by it in such fiscal year pursuant to its Local Water Treatment Agreement plus debt service with respect to such fiscal year on obligations which are secured by a pledge of a lien on the San Luis Obispo Purveyor Purchaser's net water system revenues and which are on a parity with the obligations of the San Luis Obispo Purveyor Purchaser under the Local Water Treatment Agreement. See "SECURITY FOR THE BONDS Rate Coverage Reserve Fund" below for information with respect to amounts deposited by certain San Luis Obispo Purveyor Purchaser's with the Authority which may be counted as water system revenues for purposes of computing such coverage."

Will keep looking but this is all I can find at this point.

The coverage ratio is the net revenues over expenditures divided by the state water contract amount. The state water contract payment is the denominator. For example, in FY 2016/17 the water fund had revenues over expenditures of \$3,743,043 which was divided by the state water payment of \$2,010,166 for a coverage ratio of 1.86

14. Will you consider reducing the projected 5% annual increase to SWP expense considering that the bond payment decreased in FY 17/18 from \$745K to \$666K and other SWP costs are not increasing that fast?

This is referring to the 2015 rate study and again, Alex maybe something we can work through as you do the water study tomorrow. Our FY 2018/19 budget reflects lower

SWP projections and I would be comfortable figuring out a happy medium with Alex Handlers to keep forecasts reasonable in the out years.

15. The final CCWA bond payment is forecast for FY 21/22. Does CCWA hold any reserve against the final payment or is the full amount due from the City?

I am not aware of a reserve and contacted CCWA staff to confirm. The Deputy Controller is also not aware of any. She will confirm this understanding with the Controller upon her return to the office tomorrow.

16. Table 9 includes an interest earnings rate of 1.5% through FY 21/22 and 2% thereafter. Considering that LAIF's current daily rate is already 1.83%, would you consider increasing the forecast? Could you research the Federal Reserve forecast and use that?

Really more of an Alex Handlers question. Given that the Feds are raising rates on a regular basis now I am ok with increasing the projections slightly. The feds are stating that the rates will rise to 2.1% by the end of the year and 2.9% by the end of 2019, 3.4% by end of 2020 – 2.9% long-run. Alex, would you be comfortable increasing interest rates to 2.5% in 2019/20 through 21/22 and 2.9% thereafter?

Questions to and Answers from Scott Collins:

17. How will the City utilize the recycled water when it becomes available and until 2038 when the SWP contract expires?

The City currently relies on groundwater for about 15% (~150 acre-feet/year) of its supply annually. The purified water will be discharged to the Morro sub basin to eliminate/reduce nitrate contamination and augment supply when either State Water is down for maintenance or when the City's peak demands exceeds State Water's capacity.