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ORIGINATING SECTION: Administration

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AGENDA DATE: October 16, 2024

SUBJECT: Review of Treated Water Rates for Calendar Years 2025 and 2026

SUMMARY:

- The proposed action supports Strategic Plan Goal A – Reliable Water Supply and Infrastructure – provide customers with a reliable water supply and infrastructure, and Strategic Plan Goal G – Fiscal Responsibility – operate the Agency in a fiscally responsible manner. In carrying out these fiscal responsibilities, the Agency sets rates and fees to recover the cost of service.
- Treated water rates are the primary source of revenue for Fund 100 – Water Enterprise Operations and (Fund 100) and Fund 120 - Water Enterprise Renewal & Replacement and System-Wide Improvements (Fund 120).
- On November 16, 2022, via Resolution No. 22-93, the Board adopted a four-year rate schedule for treated water rates covering calendar years (CYs) 2023, 2024, 2025, and 2026. The Resolution established 5.5% annual rate revenue adjustments and directed the Board to revisit the adopted rate schedule for CYs 2025 and 2026 through a public process, with any changed rates adopted by November 2024.
- The rate review assesses whether the adopted rates meet the Water Enterprise’s revenue requirements and achieve the additional funding objectives established by the Board during the rate-setting process. Staff has completed the review.
- Based on the results of the review and the sensitivity analysis (discussed on page 3), the adopted rates prove to be sufficient to meet the Water Enterprise’s revenue requirements and objectives, with no additional adjustments required. As demonstrated in the table below, projected reserves at the end of the four-year cycle (FY 2025-26) comply with the Agency’s Reserve Policy. Therefore, staff does not recommend any adjustments to the Board adopted rates.

(\$ millions)	Rate Study Projection	Adopted Budget	\$ Difference
Fund 100			
FY 2025-26 Year-End Reserves	\$27.3	\$30.6	\$3.3
Reserve Target	\$26.3	\$29.6	\$3.3
Above/(Below) Reserve Target	\$1.0	\$1.0	-
Fund 120			
FY 2025-26 Year-End Reserves	\$15.4	\$52.3	\$36.9
Minimum Reserve Requirement	\$15.3	\$42.1	\$26.8
Above/(Below) Reserve Minimum	\$0.1	\$10.2	\$10.1 ¹

¹FY 2025-26 projected ending reserves are \$10.1M above target due to the receipt of \$17M of PFAS grants proceeds, which were not anticipated in the rates. Any reserves above minimum will be used to fund future capital improvement projects. For example, the Agency is currently conducting a feasibility study for a potential Mocho Wellfield PFAS Treatment Facility.

DISCUSSION:

In 2022, the Agency engaged Raftelis to conduct a Treated Water Rate Study (the “Rate Study”) for the purpose of setting a multi-year rate schedule. The rates were established to meet operations and maintenance (O&M) costs, debt service, fund planned capital projects and sustain sufficient reserve balances (“Cost of Service”).

In addition, the Board determined the following key financial objectives of the adopted rate scenario:

1. Continued participation in water supply reliability projects.
2. Annual debt service and ongoing O&M for the Chain of Lakes PFAS Project.
3. \$2.9M for a portion of the Stoneridge PFAS project and capital funding.
4. Fund 100 reserves are funded at target levels by the end of the four-year rate cycle, and Fund 120 reserves meet the minimum requirement set forth in the Agency’s Reserve Policy.

A comprehensive review has been conducted to evaluate whether the adopted rates have achieved these objectives and to determine if adjustments may be required to recover Cost of Service. Please refer to Attachment A for a pro forma cash flow of Fund 100 and Fund 120. The pro forma incorporates updated financials, including unaudited actuals for FY 2023-24 and the adopted FY 2024-26 Two-Year Budget.

Based on the financial review, the following findings have been made regarding each of the key financial objectives.

Key Financial Objective	Finding
Cost of Service	<ul style="list-style-type: none"> • Adopted rates have been sufficiently covering Cost of Service with no significant budget shortfalls. • Adopted Two-Year Budget incorporates adopted rates for CYs 2025 and 2026 – sufficient revenue to continue to cover planned Cost of Service.
Continued Participation in Water Supply Reliability Projects	<ul style="list-style-type: none"> • The Agency has been actively participating in the Delta Conveyance and Los Vaqueros Reservoir Expansion projects. • Adopted Two-Year Budget plans for continued participation in these projects.
Chain of Lakes (COL) PFAS Treatment Facility Project	<ul style="list-style-type: none"> • Water Revenue Bonds, 2023 Series A, issued November 2023 to fund the COL PFAS project and other capital improvements. • Adopted rates are necessary to continue to make debt service payments, meet debt service coverage requirements, and maintain high bond ratings. • On October 1, 2024, Fitch Rating affirmed AA+ rating with a positive outlook for the bond rating. The pro forma cash flow for the ratings assumed the adopted rates.
Stoneridge PFAS Treatment Facility Project and Capital Funding	<ul style="list-style-type: none"> • \$2.9M will be contributed to the Stoneridge PFAS Treatment Facility Project and other capital projects by FY 2025-26.
Reserves	<ul style="list-style-type: none"> • Reserves will continue to comply with Agency’s Reserve Policy.

Sensitivity Analysis

In addition to staff’s comprehensive review, a sensitivity analysis was conducted to determine specific impacts on Fund 100. Staff analyzed the effect of a 5% reduction in planned acre-feet (AF) of water sales. The result of the analysis is shown in the table below:

Fiscal Year	Budgeted Water Sales (AF)	5% Reduction	Revenue Impact	Impact to Reserves
FY 2024-25	34,000	32,300	(\$3.6M)	\$2.8M below target
FY 2025-26	35,000	33,250		

In addition, staff analyzed the impact of no rate increase in CY 2025 and a 5.5% rate revenue increase in CY 2026. The result of the analysis is shown in the table below:

Calendar Year	Adopted Rate Increase	Adjusted Rate Increase	Revenue Impact	Impact to Reserves
CY 2025	5.5%	0%	(\$4.5M)	\$3.8M below target
CY 2026	5.5%	5.5%		

Based on the results of the financial review and sensitivity analysis, the adopted rates prove to be sufficient to meet the Water Enterprise’s planned revenue requirements and objectives, with no additional adjustments required. Therefore, Staff recommends the Board continue with the CY 2025 and CY 2026 rates, as adopted by Board Resolution No. 22-93, dated November 16, 2022.

On October 3 and 8, 2024, staff met with the Retailers to discuss the review findings. The retailers expressed appreciation for the meeting and informed staff that the adopted rates for CYs 2025 and 2026 have already been factored into their budgetary and rate planning processes with no additional adjustments anticipated.

FUNDING:

Treated water rates are the primary source of revenue for Fund 100 – Water Enterprise Operations and Fund 120 - Water Enterprise Renewal & Replacement and System-Wide Improvements.

RECOMMENDED ACTION:

Information only.

ATTACHMENT:

Attachment A – Pro forma Cash Flow

ATTACHMENT A

Fund 100 - Water Enterprise Operations Fund
Fund 120 - Water Enterprise Capital Renewal/Replacement and
System-Wide Improvements Fund

PROFORMA CASH FLOW (\$millions)	FY 2023-24 Unaudited Actual ¹	FY 2024-25 Budget	FY 2025-26 Budget
Adopted Rate Revenue Adjustment²	5.5%	5.5%	5.5%
Fund 100 - Water Enterprise Operations Fund			
Revenue			
Treated Water Rate Revenue	\$63.9	\$66.1	\$70.0
Miscellaneous Revenue	\$2.6	\$2.1	\$2.2
Total - Revenue	\$66.5	\$68.2	\$72.2
Expenses			
O&M Expenses	\$43.8	\$47.3	\$49.8
Debt Service	\$3.3	\$5.0	\$5.0
Capital Funding	\$16.6	\$17.1	\$17.6
Total - Expenses	\$63.7	\$69.4	\$72.4
Revenue over Expenses	\$2.8	(\$1.2)	(\$0.3)
Reserves			
Fund 100 Ending Balance	\$32.2	\$30.9	\$30.6
Fund 100 Target Balance	\$28.2	\$28.5	\$29.6
Above/(Below) Target	\$4.0	\$2.4	\$1.0
Fund 120 - Water Enterprise Capital Renewal/Replacement and System-Wide Improvements Fund			
Revenue			
Capital Revenues and Funding ³	\$16.5	\$34.3	\$17.4
Miscellaneous Revenue	\$3.2	\$1.4	\$0.8
Bond Proceeds ⁴	\$29.7	-	-
Total - Revenue	\$49.4	\$35.7	\$18.2
Expenses			
Capital Expenses ⁵	\$21.7	\$49.5	\$24.9
Total - Expenses	\$21.7	\$49.5	\$24.9
Revenue over Expenses	\$27.7	(\$13.8)	(\$6.7)
Reserves			
Fund 120 Ending Balance	\$72.8	\$59.0	\$52.3
Fund 120 Minimum Balance ⁶	\$55.8	\$31.2	\$42.1
Above/(Below) Minimum	\$17.0	\$27.8	\$10.2

Note: Amounts may not add due to rounding.

1. FY 2023-24 amounts are unaudited actuals.

2. Rate Revenue adjustments of 5.5% annually were approved by the Board via Resolution No. 22-93, dated November 16, 2022.

3. FY 2024-25 Capital Revenues and Funding includes \$17M of PFAS grant proceeds.

4. 2023 Series A Water Revenue Bond proceeds for COL PFAS and Other Capital Projects.

5. FY 2024-25 expenses include \$13.3M Board approved budget plus prior-year unspent capital budgets of \$36.2M, which will be expended in FY 2024-25.

6. FY 2025-26 projected ending reserves are \$10.1M above target due to the receipt of \$17M of PFAS grants proceeds, which were not anticipated in the rates. Per the Reserve Policy, Fund 120 does not have a target or maximum reserve requirement. Any reserves above minimum will be used to fund future capital improvement projects.