June 9, 2022

VIA EMAIL

Adam Wilson
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RE: Follow-Up to May 10 CWA Presentation

Dear Mr. Wilson:

This letter is in response to your correspondence emailed May 26th and its attached memorandum. In your memo, you outlined three additional questions resulting from my May 10th presentation to the AD Hoc Working Group.

I appreciate the opportunity to address these questions in written form, as they require detailed responses. The questions are more complex than they appear, and thus the responses are multifaceted and require appropriate context.

While some of the information requested is based on actual data, other responses are founded on projections and a presumption of the status quo. As with all industries, the water industry (both operationally and financially) continues to adapt to new technologies, regulatory pressures, and climate change. However, what has and never will change, is the vital role water plays to all life and constitution of the San Diego economic framework. As Surgeon General Scheele stated in 1952, "Water is essential to life—the life of a city as well as the life of a human being. Without water, a [person] dies. Without water, a community faces the same fate."

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1) *What are the total contributed assets, broken down by member agency (in dollars) over the last five years?*

As stated in my May 10th presentation, water is an infrastructure driven utility that is not accurately reflected in a narrowly and baselessly assigned time-series. The following table provides the percentage share of total revenue collected recorded for the past 1 year, 5 years, 10 years, and the historical lifetime of each agency. By enumerating multiple ranges, one can better identify and communicate the results of the requested data.

	5-year Contributions ($)	% Share (1yr)	% Share (5yr)	% Share (10yr)	% Share (Lifetime)
Carlsbad	$166,400,036	4.9%	4.8%	4.5%	3.7%
Del Mar	$10,665,817	0.3%	0.3%	0.3%	0.3%
Escondido	$101,156,513	3.1%	2.9%	3.3%	3.5%
Fallbrook	$71,558,859	2.1%	2.1%	2.2%	2.2%
Helix	$194,382,714	5.7%	5.6%	5.6%	6.7%
Lakeside	$27,119,110	0.9%	0.8%	0.8%	0.7%
National City (SWA)	$18,966,416	0.5%	0.5%	0.7%	0.7%
Oceanside	$185,318,306	5.3%	5.4%	5.3%	5.2%
Olivenhain	$144,513,295	4.5%	4.2%	4.1%	3.4%
Otay	$275,733,880	8.2%	8.0%	7.7%	6.0%
Padre Dam	$98,251,567	2.9%	2.8%	2.8%	2.7%
Pendleton	$508,056	0.0%	0.0%	0.0%	0.1%
Poway	**$74,690,419**	**2.3%**	**2.2%**	**2.2%**	**2.1%**
Rainbow	$133,246,992	3.9%	3.9%	4.0%	3.9%
Ramona	$44,190,254	1.2%	1.3%	1.3%	1.5%
Rincon	$52,328,006	1.6%	1.5%	1.6%	1.4%
San Diego	**$1,285,972,646**	**35.9%**	**37.2%**	**37.0%**	**39.7%**
San Dieguito	$35,493,779	1.1%	1.0%	1.0%	1.1%
Santa Fe	$58,041,000	1.7%	1.7%	1.6%	1.6%
South Bay (SWA)	$49,983,992	1.4%	1.4%	1.4%	1.9%
Vallecitos	$157,741,869	4.5%	4.6%	4.2%	3.0%
Valley Center	**$146,368,851**	**4.2%**	**4.2%**	**4.6%**	**5.0%**
Vista	$92,909,811	2.7%	2.7%	3.0%	3.0%
Yuima	$33,945,773	1.1%	1.0%	0.8%	0.5%

The vast majority of the revenue contributions are related to the direct purchase and delivery of water (treated and untreated). In 2022, roughly 72% of the Water Authority's budget was comprised of the cost of water (supply or treatment). The remaining 28% recovers the Water Authority's O&M expenses, CIP, and debt service obligations.

2) *What would the SDCWA Rate increases to (each individually) Valley Center, City of Poway, and City of San Diego be if Rainbow and Fallbrook detachment occurred using the Hanemann dollars (numbers)?*

   Before a specific response is defined, it is necessary to outline the limitation and context of "the Hanemann dollars" (presented in Dr. Hanemann's Final Report). While the Final Report itself details a range of options, including annual amounts and annual terms, the "Hanemann dollars" provide but a single *sample* calculation and suggests that "[t]hese calculations could be modified in any manner that LAFCO sees fit. In particular, the FPUD/RMWD share could be calculated for a different set of years." As discussed above, selective framing and a baseless narrowing of datum can skew results. As was demonstrated in Dr. Hanemann's Table 22, there is a 3% to 6% difference (increase) between using a 3-year review (which Hanemann uses for his calculation) rather than the 5-year or 10-year review. Without defining why a 3-year window was selected for his sample, Dr. Hanemann's 3-year singular number shifts millions of additional detachment impacts to the rest of the county.

   For a utility, such as the Water Authority, that is so infrastructure driven and volatile to annual hydrological demand impacts, a 3-year snapshot gives an unfairly limited perspective as to whether that reflects a true and reasonable indication of an agency's average, historical, or forecasted use. This may be one reason why Dr. Hanemann did not recommend using a 3-year figure, but just provided it as an exemplar. Furthermore, a 3-year snapshot remains static, remaining unchanged for the entirety of the 5 or 10-year period. Moreover still, the "Annual Payments" are based on a 2021 amount and are not shown to reflect inflation or rate adjustments – thus giving another undue discount to rates if allowed to be paid (unadjusted) over the set of years.

   To understand impacts to member agencies, the Water Authority's existing rate structure must be contextualized. The Water Authority's rate structure currently consists of a variety of fixed and variable rates. However, given the significant and material impact of Detachment on the Water Authority's finances, a complete review and overhaul of the existing structure would likely be required. As stated by law, our Board would make decisions as to cost recovery allocations. For the purposes of this request, the forecast cost increase is passed through to each agency proportional to total forecasted CY '22 rate contributions, though of course that might not be what would actually occur.

   As defined in the Water Authority's September 2020 Response to LAFCO, the Water Authority's financial impact isn't simply calculated on a single determinate -CY 2021's $284M QSA commitments (which increased to $305M in CY 2022) - but rather the entirety of its nearly $2 billion in outstanding debt, historical pension liabilities, and other incurred liabilities (indebtedness). Dr. Hanemann also acknowledged that his "estimate will understate the revenue lost due to FPUD/RMWD detachment" should the use of reserves (existing rate reduction efforts) be considered. Additionally, 75% of the Water Authority's rates are collected variably, while 90% of the annual costs are fixed. Dr. Hanemann presents a singular best-case (low impact) outcome.

Dr. Hanemann's 2021 estimate of $13M to $18.5M has been increased by 7% to reflect actual cost increases incurred since 2021. Using the same limited and prescribed data as he did in his example, the defined impact is now $13.9M or $19.8M. These costs will continue to increase to account for planned MWD rate increases and escalation variables detailed in the QSA agreements.

The estimated Detachment Impact Table provided at the end of this memo defines the estimate cost impact, by agency, assuming demands continues in the same manner as the prior year. As the Water Authority's rates are set annually to recover the actual costs, the narrowly defined and static "annual payments" are likely to be insufficient, and thus will necessitate greater increases/impacts than defined below. The impact was calculated for all agencies, not just those requested, as a dollar not collected from one of highlighted three will need to be recovered from some other agency.

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In the following paragraphs I provide the approximate annual numbers for each of the agencies identified in the question. In order to ground the magnitude of these dollars, I then divided the impact (cost increase) of each by agency's service population to get a rough per capita impact. I then extrapolated that to a rough per household impact. All numbers are annualized and for a single year.

For Valley Center, the estimated single-year impact is between $672,362 and $894,871 every year. Based on their estimated service population, this equates to a $26.26 to $34.96 annual rate impact to every resident in the Valley Center. For a typical household of 4, this is effectively an annual $105 - $140 rate increase for no additional benefit or service being provided. The below table shows the amounts that would be paid for 5 to 10 years. However, the table does not capture one key fact: *the losses continue on year after year after year*. This is because the proposed detachments are not for 5 or 10 years but are permanent – thus increasing costs for all other member agencies for all years moving forward.

For Poway, the estimated single-year impact is between $357,201 and $475,412 every year. Based on census data, this equates to a $7.38 to $9.82 annual rate impact to every resident in the City of Poway. For a household of 4, this is an annual $30 - $39 rate increase for no additional benefit or service being provided.

For the City of San Diego, the estimated single-year impact is between $5,531,072 and $7,361,498 every year. Based on census records, this equates to a $4.00 to $5.33 annual impact to every resident in the City of San Diego. For a family of 4, this signifies an annual $16 - $21 rate increase for no additional benefit or service being provided.

In California, 1 in 8 households had water debt as of January 2021.[1] Accordingly, the consideration that 98% of San Diegans should be unduly burdened with hundreds of millions in additional costs – with no corresponding benefit - is clearly problematic.

3) *Do the San Diego County Water Authority's current rates take into account the funding for capital improvements that are specifically intended to benefit both Fallbrook and Rainbow, which have not been built to date?*

The Water Authority's rates and charges are set annually based on extensive and transparent budget and rate process with its Board and its member agencies. The rates are set to recover costs detailed in the Water Authority's Adopted 2-year Budget. While FPUD/RWMD benefit from the Water Authority's extensive capital program (past and present), the North County ESP Pumping Station project *is not* included in the adopted budget and therefore *is not included* in any fashion in the Water Authority's existing rates and charges (including the proposed CY 2023).

[1] Botts. 2021. `The most basic form of PPE`: 1.6 million households face water shutoffs.

Additionally, as the Water Authority does not have funds (cash/reserves) available to fund this project (should it be budgeted and approved) – the project would be funded with additional debt issuances. It is an industry best practice and common for new facilities to be funded with new debt, as it provides generational equity benefits alignment of the facilities use (benefit) with its cost (service).

As Dr. Hanemann adeptly described, "[t]here seems to be a degree of inconsistency in the position adopted by FPUD/RWMD - past financial commitments incurring ongoing payments and debt service appear not to be relevant when assessing FPUD/RMWD detachment, but future invests that would not be incurred *are* relevant to that assessment." The "Hanemann dollars" only reflect the Water Authority's QSA obligations and no share or obligation of the Water Authority's nearly $2 billion of outstanding debt (due to historical system investment).

Therefore, the simple answer is that the current rates do not include payment of the ESP project that will benefit Fallbrook and Rainbow. If this approximately $30-million project were debt financed, as is typical, then the estimated impact on Water Authority rates and charges would equate to roughly a small one-time 0.3% increase applicable over the life of the debt.

Or, to frame it in a manner of what might be of most interest to LAFCO and our other member agencies, if Rainbow and were to detach without compensation to the Water Authority, in a base year we estimate about a 6.0-7.0% annual loss in revenue. If the ESP debt financing were not necessary, this annual loss in revenue would only be offset by a much smaller 0.3%, thus minimally reducing our annual loss to be made up by other member agencies to an annual base year loss of 5.7-6.%.

Sincerely,

Pierce Rossum
Rate & Debt Manager

Cc via email:

Adam Wilson, Ad Hoc Committee Moderator
Keane Simonds, Executive Officer, San Diego LACFO
Sandra L. Kerl, General Manager, San Diego County Water Authority
Water Authority Board of Directors
General Managers of Water Authority Member Agencies

The following table defines the forecasted rate impact of detachment, using escalated figures of those defined in Dr. Hanemann's Final Report. The results reflect a high-level approximation. Should detachment be approved, and once final financials are known, the Water Authority foresees the need to complete a comprehensive cost-of-service and rate structure study, validated by an independent cost of service consultant, to incorporate the millions in added rate burden.

Detachment Impact	'22 Estimated Revenue Share	Detachment Impact		Detachment Impact (5-year)		Detachment Impact (10-year)	
		Low	**High**	**Low**	**High**	**Low**	**High**
		$13,900,000	**$18,500,000**	**$69,500,000**	**$92,500,000**	**$139,000,000**	**$185,000,000**
Carlsbad M.W.D.	4.02%	$559,125	$744,159	$2,795,624	$3,720,795	$5,591,249	$7,441,590
Del Mar, City of	0.27%	$37,758	$50,254	$188,792	$251,270	$377,584	$502,540
Escondido, City of	3.28%	$456,123	$607,070	$2,280,615	$3,035,351	$4,561,230	$6,070,702
Fallbrook P.U.D.							
Helix W.D.	6.60%	$917,784	$1,221,511	$4,588,918	$6,107,553	$9,177,836	$12,215,106
Lakeside W.D.	0.99%	$138,085	$183,782	$690,425	$918,911	$1,380,850	$1,837,822
Oceanside, City of	5.94%	$825,251	$1,098,356	$4,126,256	$5,491,780	$8,252,513	$10,983,560
Olivenhain M.W.D.	4.91%	$682,514	$908,382	$3,412,568	$4,541,908	$6,825,137	$9,083,815
Otay W.D.	9.27%	$1,288,829	$1,715,348	$6,444,144	$8,576,739	$12,888,288	$17,153,477
Padre Dam M.W.D.	3.17%	$441,105	$587,082	$2,205,524	$2,935,410	$4,411,048	$5,870,820
Pendleton Military	0.01%	$1,782	$2,371	$8,908	$11,856	$17,815	$23,711
Poway, City of	**2.57%**	**$357,201**	**$475,412**	**$1,786,006**	**$2,377,059**	**$3,572,012**	**$4,754,117**
Rainbow M.W.D.							
Ramona M.W.D.	1.27%	$176,686	$235,158	$883,430	$1,175,788	$1,766,860	$2,351,577
Rincon Del Diablo	1.60%	$222,570	$296,227	$1,112,852	$1,481,134	$2,225,704	$2,962,267
San Diego, City of	**39.79%**	**$5,531,072**	**$7,361,498**	**$27,655,359**	**$36,807,492**	**$55,310,718**	**$73,614,985**
San Dieguito W.D.	1.07%	$148,126	$197,147	$740,632	$985,733	$1,481,264	$1,971,467
Santa Fe I.D.	1.78%	$247,737	$329,721	$1,238,683	$1,648,607	$2,477,366	$3,297,214
Sweetwater Authority	1.17%	$162,854	$216,749	$814,272	$1,083,743	$1,628,544	$2,167,487
Vallecitos	3.51%	$487,635	$649,010	$2,438,173	$3,245,051	$4,876,347	$6,490,101
Valley Center	**4.84%**	**$672,362**	**$894,871**	**$3,361,811**	**$4,474,353**	**$6,723,622**	**$8,948,706**
Vista I.D.	2.57%	$356,694	$474,736	$1,783,468	$2,373,680	$3,566,936	$4,747,361
Yuima M.W.D.	1.32%	$184,095	$245,019	$920,477	$1,225,095	$1,840,953	$2,450,189
Contract Water	0.03%	$4,612	$6,139	$23,062	$30,693	$46,123	$61,387