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Castaic Lake Water Agency  
FY 2011/12 Long-Term Financial Plan

July 1, 2011

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## EXECUTIVE SUMMARY

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A long-term financial plan (LTFP) is not a static, one-time document, but represents a process where the Board and management review financial strategies to help achieve the Agency's overall strategic plan. This FY 2011/12 LTFP represents an updated look at individual financial strategies and serves as the basis for future analysis and decision making. The LTFP helps to identify potential financial issues and risks. This FY 2011/12 LTFP groups financial strategies into near-term, mid-term and long-term issues, to help prioritize the work. Based on the decisions and guidance provided by the Board, the Plan is a rolling "look-ahead" to help identify priorities and focus. The Agency's management team has collaborated on this long-term financial plan by taking a thoughtful look at the Agency's programs and the financial implications of those programs. Recent long-term planning efforts that impacted the LTFP included the draft 2010 Urban Water Management Plan and the 2010 Data Document used to develop Facility Capacity Fees. Previous to these efforts, the management team has also (1) reviewed the work prepared by CDM Consulting in 2006 as part of the update process for Facility Capacity Fees, (2) "A Strategic Assessment of the Future of Water Utilities" prepared by Ed Means for the AWWA Research Foundation in 2006 and (3) the August 2007 presentation prepared by Ed Means of Redoak Consulting, a division of Malcolm Pirnie.

This LTFP is separate from the Agency's Strategic Plan and its objectives, goals and action items. This plan is intended to discuss financial strategies to achieve the Agency's strategic plan as well as respond to challenges and opportunities presented by economic, demographic, regulatory, political and environmental conditions.

The LTFP is not intended to address every fiscal issue, but identify high priority fiscal programs and strategies to be monitored over time, so that the Agency is positioned to address them at the appropriate time. The LTFP is a companion piece to the multi-year financial forecast, which estimates budget line items for the near future. The LTFP addresses broader, more strategic issues that will impact the forecast over time.

None of these issues can be definitively answered nor fully addressed now. However, ongoing review of the LTFP will help to keep the Agency focused on high priority financial issues.

As discussed by Ed Means during his August 2007 presentation to the Board, the political environment for water utilities is growing more complex. Rate rises will be politicized and the water utility industry should prepare for this future by improved financial and capital improvement program transparency. This long-term financial plan is intended to help the Agency to achieve this objective.

Each of the sections of this Plan has been reviewed and updated. Some sections have changed significantly, and those areas are highlighted in each section.

The individual financial issues include:

Ongoing

- ◆ Total Cost of Water
- ◆ Diversity and Security of Revenues
- ◆ Debt Financing of the Capital Improvement Program

Near-Term

- ◆ Water Conservation
- ◆ Wholesale Water Rate Structure
- ◆ Recycled Water
- ◆ Energy

Mid-Term

- ◆ Operations and Maintenance
- ◆ Capital Improvement Program for Existing Users
- ◆ Buena Vista/Rosedale Rio Bravo Water Program Funding
- ◆ Facility Capacity Fees
- ◆ Impact of Health Care Reform

Long-Term

- ◆ Reliability (Banking) Programs Funding
- ◆ State Water Contract Fund
- ◆ Security

## TOTAL COST OF WATER (Ongoing)

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The Agency has funded the ongoing purchase and treatment of water from three sources – wholesale water rates, State Water Contract Fund (ad valorem taxes) and one percent property tax funds. (Note that purchases of “new” supplies of water are also partially-financed through Facility Capacity Fees; this discussion reflects annual costs to treat and deliver water to the purveyors.) The diversity of funding sources strengthens the Agency’s fiscal position, but masks the “true” cost of water. While the wholesale water rate is \$478/AF, the total cost of water is closer to \$1,200 per AF, as shown on the following pages. Staff will publish this table as part of the budget each year, to enhance understanding of the “cost of water.”

As discussed in “A Strategic Assessment of the Future of Water Utilities,” “Water utilities should include financial targets in their mission statements and have policies on rates and financial returns that ensure ongoing financial health.” A consolidated understanding of all of the Agency’s costs to treat and distribute water will help establish the appropriate policies and ensure ongoing financial health.

The Agency should continue to monitor how water supplies are funded and, as discussed above, the Agency should consider funding new programs (banking, recycled water, conservation, etc.) through “surcharges” or “components” of water rates, to enhance the visibility of the costs of these programs and more directly links costs to benefits.

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<b>TOTAL COST OF WATER *</b>					
	<b>FY 2007/08</b>	<b>FY 2008/09</b>	<b>FY 2009/10</b>	<b>FY 2010/11</b>	<b>FY 2011/12</b>
	<b>Actual</b>	<b>Actual</b>	<b>Actual</b>	<b>Estimated</b>	<b>Budget</b>
<b>CLWA Operating Budget</b>					
Total	\$ 11,972,443	\$ 13,105,490	\$ 13,294,172	\$ 14,675,000	\$ 16,123,500
Detail on Power Costs					
Electricity - Treatment Plants	345,307	256,855	309,995	305,000	350,000
Electricity - Pumping	1,198,594	1,089,572	1,111,004	1,067,000	1,300,000
Electricity - Other	49,764	43,137	44,688	43,000	50,000
Electricity - Wells	-	-	5,553	220,000	310,000
	<u>\$ 1,593,665</u>	<u>\$ 1,389,564</u>	<u>\$ 1,471,240</u>	<u>\$ 1,635,000</u>	<u>\$ 2,010,000</u>
Power as a Percentage	13.3%	10.6%	11.1%	11.1%	12.5%
<b>SWP Budget **</b>					
Total	\$ 16,941,022	\$ 20,490,241	\$ 19,235,784	\$ 21,410,300	\$ 25,617,200
Detail on Variable Costs (Power)					
Variable	4,488,388	4,667,948	2,750,291	3,000,000	4,200,000
Off-Aqueduct Power Costs	<u>1,876,229</u>	<u>4,009,676</u>	<u>5,521,900</u>	<u>4,721,400</u>	<u>4,957,500</u>
	<u>\$ 6,364,617</u>	<u>\$ 8,677,624</u>	<u>\$ 8,272,191</u>	<u>\$ 7,721,400</u>	<u>\$ 9,157,500</u>
Power as a Percentage	37.6%	42.4%	43.0%	36.1%	35.7%
<b>Core Non-SWP Supplies</b>					
BV/RRB	\$ 5,796,256	\$ 5,949,400	\$ 5,709,627	\$ 5,760,000	\$ 5,932,800
Yuba Accord Water	-	-	564,224	1,000	65,000
	<u>\$ 5,796,256</u>	<u>\$ 5,949,400</u>	<u>\$ 6,273,851</u>	<u>\$ 5,761,000</u>	<u>\$ 5,997,800</u>
<b>TOTAL COST OF WATER</b>	<b>\$ 34,709,721</b>	<b>\$ 39,545,131</b>	<b>\$ 38,803,807</b>	<b>\$ 41,846,300</b>	<b>\$ 47,738,500</b>
<b>TOTAL COST OF POWER</b>	<b>\$ 7,958,282</b>	<b>\$ 10,067,188</b>	<b>\$ 9,743,431</b>	<b>\$ 9,356,400</b>	<b>\$ 11,167,500</b>
<b>Power as a Percentage</b>	<b>22.9%</b>	<b>25.5%</b>	<b>25.1%</b>	<b>22.4%</b>	<b>23.4%</b>
AF Delivered	44,735	38,276	34,648	33,200	39,700
Cost per AF	\$ 775.90	\$ 1,033.16	\$ 1,119.94	\$ 1,260.43	\$ 1,202.48
* This table reflects all "water"-related costs, and divides by the amount of treated water the Agency delivers to the purveyors.					
** This includes all SWP costs, including "capacity" and "reliability" charges. This amount is included in the total that is divided by the amount of treated water the Agency delivers to purveyors. It may be more accurate to allocate certain "capacity" and "reliability" charges by Table A amount (95,200 AF) and then multiply by the AF delivered to the purveyors.					

## **DIVERSITY AND SECURITY OF REVENUES (Ongoing)**

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The Agency has historically experienced low wholesale water rates throughout its history, generally due to reliance upon one percent property tax revenues to fund debt service, capital improvement projects and capital planning programs for existing users, as well as for rate stabilization. In addition, the Agency has used one percent property taxes to fund non-SWP water supply and various studies related to engineering, safety, organizational issues and other such activities. Some of these programs could be considered operating costs, and a case could be made for including the funding in wholesale water rates.

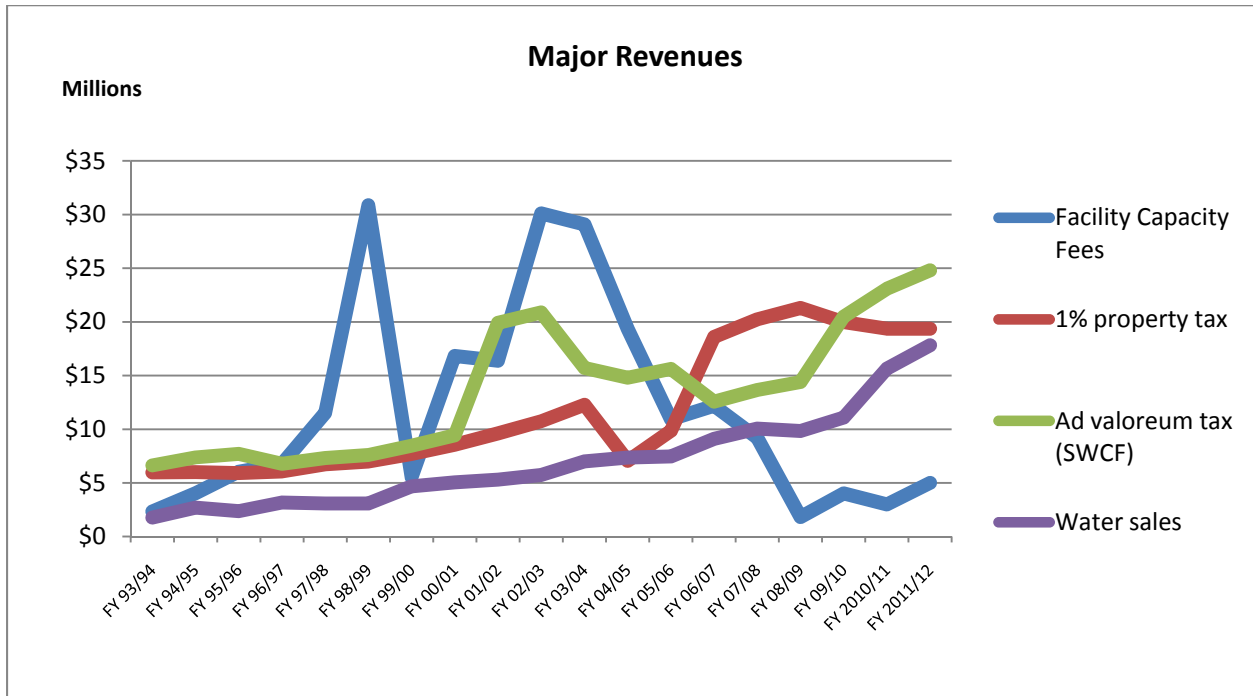
While this practice has kept water rates low, it results in significant costs being funded by a revenue source over which the Agency has little control. Historically, the wholesale water rate has generated about 15% of the Agency's total revenues. In FY 2009/10, the Board of Directors adopted a new wholesale rate structure designed to fully recover operating costs. Based on this, it is anticipated the wholesale water rate will generate about 23% of the Agency's total revenues during FY 2011/12.

The Agency considers one percent property tax revenues subject to temporary or permanent seizure by the State of California. *If this should occur, the Agency would likely have severe reductions in service and significant increases in wholesale water rates.*

In general, it may bring enhanced financial stability and also better reflect the true cost of water if the Agency were to shift additional costs to the wholesale water rates. An example could be to include half of capital expenses in wholesale water rates. Capturing more costs in wholesale water rates should help the Agency maintain or improve its credit rating.

Of course, any discussion of rates should take into consideration the balance between revenue needs and ratepayer impacts.

In addition, the Agency may want to consider new revenue sources, such as through the sale of water supply when water supplies are sufficient to meet Agency needs, or through the imposition of water standby charges as permitted by the Agency's governing act.



	WWR* Revenue	Total Revenue	%
FY 1997/98	\$ 3,089,358	\$ 33,186,516	9%
FY 1998/99	\$ 3,081,745	\$ 54,379,286	6%
FY 1999/00	\$ 4,679,476	\$ 31,144,740	15%
FY 2000/01	\$ 5,050,974	\$ 50,159,660	10%
FY 2001/02	\$ 5,307,405	\$ 60,549,326	9%
FY 2002/03	\$ 5,738,667	\$ 77,688,500	7%
FY 2003/04	\$ 7,002,983	\$ 70,357,291	10%
FY 2004/05	\$ 7,359,265	\$ 55,668,952	13%
FY 2005/06	\$ 7,462,606	\$ 51,995,786	14%
FY 2006/07	\$ 9,110,221	\$ 66,164,587	14%
FY 2007/08	\$ 9,875,546	\$ 71,372,148	14%
FY 2008/09	\$ 9,717,294	\$ 76,924,159	13%
FY 2009/10	\$ 11,080,798	\$ 61,586,300	18%
FY 2010/11	\$ 13,172,200	\$ 65,122,800	20%
FY 2011/12	\$ 16,564,700	\$ 70,835,700	23%

\* Wholesale water rate

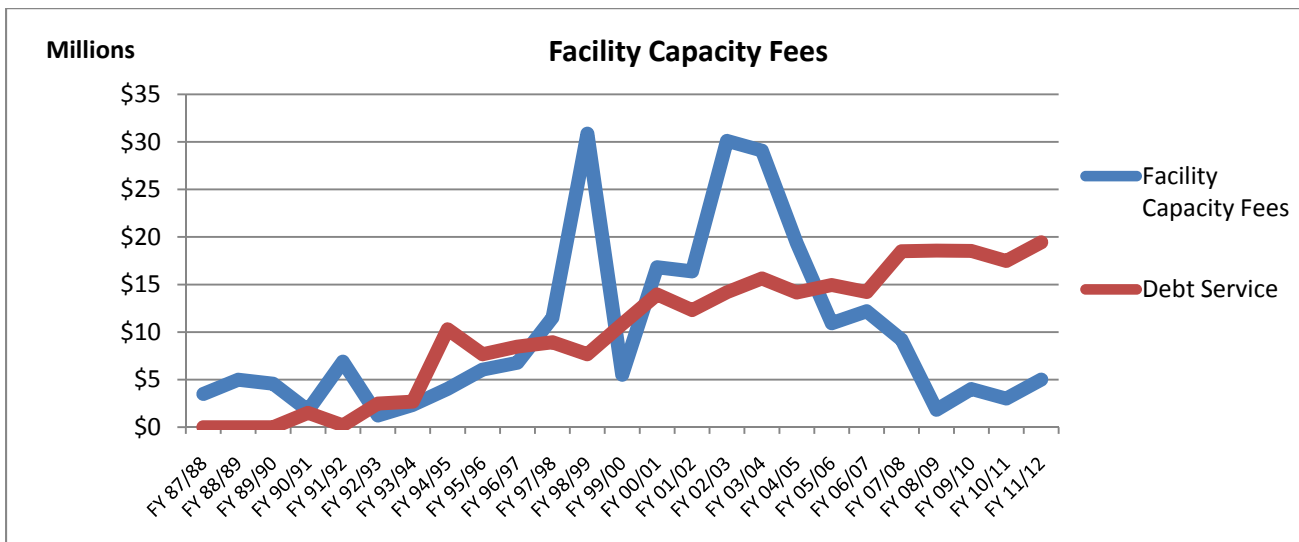
## DEBT FINANCING OF CAPITAL IMPROVEMENT PROGRAM (Ongoing)

The Agency's Strategic Plan states that the Agency will utilize reasonable debt financing as an acceptable and appropriate approach to fund long-term facility investments and thus ensure that existing and future users pay their fair share.

The Agency's Debt Management Policy states that the Agency will utilize reasonable debt financing as an acceptable and appropriate approach to fund long-term investments and thus ensure that existing and future users pay their fair share. Long-term investments include the acquisition of land, facilities, public works, improvements and supplies of water; and enhancements or enlargements to existing capacity and facilities for obtaining, importing, transporting and delivering additional quantities of water.

Debt is a way of spreading out the cost of capital improvements over time. In general, public agencies find that debt financing is an appropriate use for one-time projects, generally with a life of 10 years or more.

The majority of the Agency's capital programs are required for future needs. This makes the use of debt appropriate for two reasons: (1) debt financing allows each generation to pay for what it uses and (2) Facility Capacity Fees collected in one year may not be expended until future years. Likewise, in some years, there will not be sufficient Facility Capacity Fees collected to cover that year's debt service.



In 2006, the Agency engaged CDM Consultants to assist with the review and preparation of updated Facility Capacity Fees. In discussions, CDM has stated that it is not unreasonable nor uncommon to include all debt service (principal and interest) in a facility capacity fee calculation. However, it does add risk to an Agency's finances as the revenue stream from development-based activity is not steady. For this reason, some agencies include the interest payments in rate calculations or property taxes, to alleviate some of the risk factor. At this

time, the Agency may have sufficient Facility Capacity Fee revenue to continue with the current arrangement; however, this situation should be monitored over time.

Another aspect of the Agency's debt management program is the Agency's relationship with rating agencies and its bond ratings. As discussed in "A Strategic Assessment of the Future of Water Utilities," "Water utilities should . . . examine ways to improve their bond ratings." The Agency may want to consider enhancing its credit rating and marketability of Agency debt to investors to obtain the lowest possible annual debt service.

Debt Financing and Facility Capacity Fees

Appendix B of the FY 2011/12 Budget includes the Agency's COP-funded project forecast, projecting when current COP funds will be exhausted. For the anticipated CIP, the forecast shows that COP proceeds will be exhausted in FY 2012/13 and approximately \$82 million will be required to complete those projects. If debt-financed, the debt service is estimated to be over \$6 million per year, funded by a combination of Facility Capacity Fees and one percent property tax revenues.

The Agency has typically used debt financing to fund capital improvement projects, but would review its financial situation prior to considering any future debt to ensure it can continue to meet reserve and debt coverage requirements. If debt financing is not the best funding source for these projects, the Agency would review grant funding or pay-as-you-go funding. If these sources are not available, the Agency could reduce the scope of or defer projects.

At this time, Facility Capacity Fee revenues may not be sufficient to fund additional debt service. During FY 2011/12, management will actively monitor the status of the Agency's revenues and CIP throughout the year. For the projects in the design phase, the Agency' will complete final design. *After final design, the Agency will review the Agency's financial status before making a recommendation to proceed with construction. If revenues are not sufficient to support additional borrowing, the projects will be deferred.*

Debt Financing and One Percent Property Tax Revenues

A more long-term aspect of this issue is the Agency's transition to "build out." Debt service incurred for future users is funded by Facility Capacity Fees and that incurred for existing users is funded by one percent property tax revenues. Through the Agency's history, most of the debt service has been funded by Facility Capacity Fees. The Agency is at a transition point where approximately half of the users are existing users. The debt service funding will transition to existing users. Should one percent property tax revenues not be sufficient to fund increasing debt service, other mechanisms to fund the existing users share would include a component of the wholesale water rate or a parcel charge.

	Current Debt Service	Projected Debt Service for Next Issue
Facility Capacity Fee allocation	80%	58%
One Percent Property Tax allocation	20%	42%

## **WATER CONSERVATION (Near-term)**

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The Agency promoted 10% annual water conservation in past Urban Water Management Plans. In the 2010 Urban Water Management Plan (UWMP), the Agency goal is to achieve 20% per capita conservation by the year 2020.

During FY 2008/09, the Board of Directors adopted a Water Use Efficiency Strategic Plan (Plan) for the Santa Clarita Valley. The Plan identifies a comprehensive long-term conservation effort for the Valley that meets the regions goal of achieving a ten percent water conservation savings through the adoption of policies and programs designed to promote a long-term water-use ethic. To achieve a goal of ten percent water conservation by 2030, the study relied on both programs to increase water use efficiency of existing water users and significantly greater efficiency by future residents and business development. The majority of water savings were achieved from the latter. While the FY 2011/12 Budget includes \$1.18 million in the General Fund/Operating Budget for key initiatives existing water users, the low growth rates experienced since 2008 to date have significantly delayed water savings anticipated from future users.

In the fall of 2009, the Legislature passed SBX7-7, which requires urban water users to decrease per capita water use by twenty percent by 2020. Failure to meet this goal currently results in an agency not being eligible for state grants. Working in cooperation with the retail water purveyors, the region anticipates meeting this goal through a combination of offsetting approximately 3,000 AF water demand with recycled water and reduced water usage of approximately 16,600 AF in 2020.

The 2009 Strategic Planning workshop identified a need to further review increased investment in a conservation-related capital improvement program, as well as the need to identify a funding source for that program.

Staff will continue to monitor the progress of the Water Use Efficiency Strategic Plan. As the plan is implemented and conservation is measured, there may be a need to explore additional conservation efforts including pricing incentives. Depending on this review, there may be a need to develop a funding strategy for future enhanced conservation efforts.

## WHOLESALE WATER RATE STRUCTURE (Near-term)

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In August 2009, the Board adopted a rate structure for calendar years 2010, 2011 and 2012 that is designed to recover operating costs. The rates that have been established are as follows: \$420/AF effective January 1, 2010, \$478/AF effective January 1, 2011 and \$507/AF effective January 1, 2012. Beginning in July 2010 and thereafter, \$20/AF of the wholesale water rate is designated for operating reserves.

In the future, the Board of Directors may consider including additional components to the wholesale water rate. Further, the Board of Directors should consider wholesale and recycled water rate structures that incentivize and maximize conjunctive use of the service area's sources of supply. During FY 2011/12, the Agency will engage a consultant to perform this rate study, in anticipation of rates to take effect January 1, 2013.

### ***Structure of the Wholesale Water Rate***

The Agency currently uses a "postage stamp" rate – that is, one unit rate for every acre foot of water. This is derived by dividing total operating expenses by estimated acre feet of water to be sold. While the majority of costs are fixed, all revenues are variable. In the future, the Agency may want to consider different means of establishing a wholesale water rate, depending on the desired objectives. An example could be to include half of capital expenses in wholesale water rates.

As discussed in "A Strategic Assessment of the Future of Water Utilities," "Water utilities should consider better matching their high fixed costs as a fixed component of rates to reduce sales volume risk." Other ideas for wholesale water rate design include:

- ◆ Shift costs from the variable rates to more stable, fixed charges, such as standby charges, system access or readiness-to-serve charges.
- ◆ Use a Rate Stabilization Fund designed to capture excess revenues in high water sales years, to be available for low water sales years. An example target funding level could be equivalent to the financial loss resulting from two years of above average rainfall.
- ◆ Create a General Fund/Operating Budget reserve fund.
- ◆ Divide the rate into a series of components, such as:
  - Readiness-to-serve
  - Water supply (could include O&M)
  - Capacity
  - Customer service or administrative
  - Water supply reliability
  - Security
  - Water Quality

## RECYCLED WATER (Near-term)

The Agency's draft Recycled Water Master plans calls for a target capacity of 17,400 AFY of recycled water. In order to achieve this, recycled water will have to be deployed in areas that are currently developed. To connect existing users to a recycled water system is expensive. But if this financial constraint is not addressed, the Agency may not be able to achieve the goal of 17,400 AFY.

In regards to operating costs, the draft Recycled Water Master plan states that ". . . to encourage its use, recycled water should be available at a lower rate to users than potable water." Based on this, the Agency adopted a rate in 2002 that set the rate at 80% of the retail rates for potable water. At this time, the Valencia Water Company pays \$464/AF for recycled water as compared to \$478/AF for potable water. The current recycled water system consists of one turnout provided to one purveyor at a single location, which is simple and cost effective to operate.

Fiscal Year	AF Sold	Rate/AF	Revenue
FY 2003/04	259	\$ 316	\$ 83,774
FY 2004/05	418	\$ 331	\$ 138,432
FY 2005/06	406	\$ 328	\$ 133,364
FY 2006/07	380	\$ 327	\$ 124,263
FY 2007/08	437	\$ 366	\$ 159,987
FY 2008/09	296	\$ 386	\$ 114,116
FY 2009/10	338	\$ 432	\$ 146,127
FY 2010/11	336	\$ 464	\$ 156,000
FY 2011/12	336	\$ 464	\$ 156,000

At this time, these funding mechanisms need further review. Phase 2 of the recycled water program is in active design phase and will likely start operations in calendar year 2014. The system will have multiple turnouts and multiple customers and a different rate structure should be developed. During FY 2011/12, the Agency will engage a consultant to perform a water rate study to recommend wholesale and recycled water rates that incentivize and maximize conjunctive use of the service area's sources of supply.

## ENERGY COSTS (Near-term)

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As discussed by Ed Means during his August 2007 presentation to the Board, upcoming financial constraints include energy volatility. The table depicting the total cost of water included earlier in this plan shows that over 20% of the total cost of water is for energy. The Agency should be aware of the significance of these costs and review energy saving techniques where appropriate.

As discussed in "A Strategic Assessment of the Future of Water Utilities:"

- ◆ "The price of energy will trend higher, and with increased instability. It will be difficult for water agencies to predict energy prices accurately and to pass the additional costs through to consumers effectively."
- ◆ "Energy shortages may occur with increased frequency. Water systems will need increased capability to switch to alternate supplies during more frequent shortages."
- ◆ "Energy use is, and will remain, a large component of the cost of water. Higher costs will increase the need to focus on energy efficiency."
- ◆ "Consideration should be placed on energy costs as a pass-through cost in rates."

To reduce exposure to future energy cost increases, the Agency has entered into a power purchase agreement (PPA) with SunPower, Inc for a power generated from a photovoltaic power generation facility to be constructed at the Agency's Rio Vista Water Treatment Plant (RVWTP). The RVWTP and Headquarters facilities represent approximately 15 to 20 percent of the Agency's energy consumption. While the PPA will result in a marginal increase in the rate the Agency currently pays for energy at this facility, it is anticipated that energy cost inflation will result in lower costs in approximately five years.

Opportunities may exist to produce additional solar power at the RVWTP to provide service to the Rio Vista Intake Pump Station (RVIPS) located about a 1.4 miles from the proposed solar generation facility. The RVIPS utilizes about twice the energy currently consumed by the RVWTP. Construction of a facility could be concurrent with the construction of the Phase 2B recycled water transmission main in Newhall Ranch Road. An evaluation of the project economics would be made at that time. Given current energy prices and the termination of certain subsidized energy pricing by Southern California Edison, the project does not currently appear justifiable.

## **OPERATIONS AND MAINTENANCE (Mid-term)**

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The Agency's infrastructure is expanding and will continue to expand. The number and complexity of Agency facilities have grown in recent years and will continue to do so. Each major CIP project that becomes operational adds new complexity and costs to the Agency's overall system. As this additional infrastructure is implemented, the Agency will require additional staff resources and will incur additional costs to operate and maintain the infrastructure. This is one of the key issues identified by Ed Means of Redoak Consulting, a Division of Malcolm Pirnie, during his August 2007 presentation to the Board. Recent Agency budgets have added some resources to address the new infrastructure, but this issue should be studied further. The Agency should develop a method to fully understand the impact of the CIP on operating costs. That is, when a project is added to the CIP, its cost is not just the cost of the capital improvement program, but includes the ongoing costs to operate and maintain that project.

A more long-term aspect of this issue is to prepare for the time when the Agency system has been "built out." At this time, the Agency has a fairly new infrastructure with low maintenance costs. The Agency should prepare for increasing maintenance costs and ongoing repair and replacement.

The Agency currently funds operating and maintenance costs through the wholesale water rate, and repair and replacement with one percent property tax revenues. Is this arrangement sufficient for the future? Or should the Agency consider a repair and replacement component to the wholesale water rate?

As discussed in "A Strategic Assessment of the Future of Water Utilities," "Water utilities should formally document infrastructure and rate needs and communicate their needs to stakeholders."

## **CAPITAL IMPROVEMENT FOR EXISTING USERS (Mid-term)**

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Through the Agency's Data Document and Facility Capacity Fee process, a Capital Improvement Program (CIP) for new infrastructure is developed. The benefits and costs of the new infrastructure are allocated to future and existing users, and funding is provided by Facility Capacity Fees and one percent property tax revenues, respectively. The funding of the new infrastructure for existing users is included in the Agency's multi-year financial forecast.

However, because the Agency's infrastructure is relatively new, a repair and replacement CIP has not been developed to maintain the infrastructure in the future. That is, the Agency's CIP tends to construct and expand water treatment plants, pump stations, pipelines and other such infrastructure. As that infrastructure ages, the CIP will transition to replacing pumps, pipeline, treatment plant components, etc. At some point, the Agency will transition its emphasis from building new facilities to asset management of existing facilities. Asset management should be designed to extend the useful lives of current facilities at the lowest possible life cycle cost while maintaining reliability at appropriate levels. This asset management program should develop the appropriate mix of maintaining, repairing and replacing assets.

There will be a significant cost component to this CIP, and those costs should be incorporated into the Agency's multi-year financial forecasts. Until this component of the CIP is developed, the Agency will not have sufficient information for long-term financial forecasting.

## **BUENA VISTA/ROSEDALE RIO BRAVO WATER PROGRAM FUNDING (Mid-term)**

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In 2007, the Agency entered into a 30-year agreement for 11,000 AFY of water known as the Buena Vista/Rosedale-Rio Bravo (BV/RRB) water. This is 100% reliable Kern River water. At the time it was acquired, it was intended to supplement the Agency's SWP supplies, which are committed to users in the Agency's existing service area, by providing water for parties seeking to annex to the service area. The Agency began funding the program with one percent property tax revenues and assumed that annexing parties would reimburse one percent property tax revenues for their shares. Since that time, due to the Wanger federal court decision regarding protection of the Delta smelt under the Endangered Species Act, the Agency stopped processing annexations and is using the BV/RRB water within the existing service area. Because of this, the Agency should review its funding of this program. It is currently funded by one percent property tax revenues, but the Agency may want to consider including the existing users' share in wholesale water rates and including future users' share in Facility Capacity Fees. If this approach is used, the allocation of costs will change over time as the Agency approaches build-out. That is, the Agency may reach a point where all of the benefits are received by existing users, and all of the costs will be paid by existing users.

*If the annual cost of approximately \$6 million were funded by the wholesale water rate, the cost would be approximately \$170/AF (based on sales of 35,000 AF).*

As discussed above, over the long-term assuming SWP reliability does not improve to pre-Wanger court decision levels, the BV/RRB water would be required to meet Agency demand without water conservation. In the near-term, however, the SWP water supplies should be sufficient to meet all of the imported water service area demand in most years. The BV/RRB water thereby represents a potential asset. The Agency may be able to utilize the water supply to offset future cost of water storage programs through such mechanisms as unbalanced exchange or storage programs. It may also be possible for the Agency to enter into short term water transfers to generate a source of revenue directly.

## **FACILITY CAPACITY FEES (Mid-term)**

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As reported in the FY 2010/11 LTFP, during FY 2008/09, the Agency updated its Facility Capacity Fees, which cover the cost of providing facilities to supply water for new development. That is, Facility Capacity Fees cover those costs that are attributed to future users. The new fees went into effect January 12, 2009. Overall, the fees increased. However, due to the lack of development activity, there was little revenue associated with the increased fees. The FY 2010/11 LTFP further reported that even when development was to increase and revenues correspondingly increase, the Agency's 10-year forecast projected that Facility Capacity Fee revenues would not be sufficient for full funding of reserve requirements or for the issuance of new debt. Reserve funding would be covered by one percent property tax revenues until revenues increase. The issuance of new debt would be deferred until revenues were sufficient to support debt service.

At this time, Facility Capacity Fee revenues continue to be at low levels and one percent property tax revenues are being used for fund reserves. In March 2011, the Board of Directors adopted two Facility Capacity Fee rates increases, one scheduled for January 1, 2012 and the second scheduled for January 1, 2013. These rate increases should significantly increase the revenue and full funding of reserves should be restored, as well as the ability to issue new debt.

Facility Capacity Fee revenues are always difficult to estimate due to the unpredictable timing of receipts. Collection of this revenue depends heavily on development activity which, in turn, depends on real estate demands, the regional economic situation, land use planning activity, coordination with other projects and other difficult-to-estimate activity. This revenue stream will always demonstrate a "boom or bust" pattern and will always be difficult estimate.

## **IMPACT OF HEALTH CARE REFORM (Mid-term)**

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During 2010, federal health care reform legislation was enacted. It is likely this legislation will increase the Agency's health care costs. At this time, the program is too new for an analysis, but the Agency will continue to monitor this program. It is likely this program will have significant administrative impacts and will increase administration costs.

## **RELIABILITY (BANKING) PROGRAMS FUNDING (Long-term)**

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The Agency should review its reliability (banking) programs and determine appropriate funding sources. The Agency currently participates in two short-term programs and one long-term banking program. The two short-term banking programs are the Semitropic banking programs and the long-term program is the Rosedale Rio Bravo program.

The Agency periodically reviews its need for reliability programs in order to meet water demands during times of drought or emergency. Most recently the Agency completed the 2009 Water Supply Reliability Plan Update and anticipates completing a further update in calendar year 2011. The 2009 update indicates a need for approximately 133,000 AF of storage capacity by 2050. As the Agency has sufficient water in storage to meet near-term storage requirements, as discussed below, a significant quantity of that storage is located in a mid-term storage program. The ultimate need for storage programs will be impacted by several factors including (1) the ability of DWR to successfully complete the BDCP and DHCCP process and thus improve SWP water supply reliability, (2) the success of the Agency in achieving the water conservation goals of SBX7-7 (20 percent by 2020) and (3) the Agency's ability to implement its Recycled Water program. Significant financial resources may be required to meet any additional Agency's needs. For example the Semitropic-Rosamond Water Bank Authority program costs include approximately \$700 per AF of storage capacity plus \$150/AF in storage/extraction fees, in addition to energy costs to recover stored water.

*The Agency has funded the capital costs for the existing programs, but will incur significant costs for future withdrawals from the programs, as well as for the development of emergency storage. Funding sources have not been identified for these programs.*

During FY 2008/09, the Board of Directors approved an increase of \$20/AF to the wholesale water rate and passed the extraction costs through to the purveyors. As withdrawal programs arise, the Agency should review its options and develop the appropriate funding source. *Funding sources have not been identified for future withdrawals.*

During FY 2010/11, the Agency and the Semitropic Water Storage District negotiated ten-year extensions to the Agency's two short-term accounts in the Semitropic Water Storage Districts Groundwater Banking Program. One account is set to expire in 2012 and the other in 2013. As a result of the extensions, the accounts will expire in 2022 and 2023, respectively.

### ***Rosedale Rio Bravo Water Storage District Banking and Exchange Program***

Also located in Kern County, the Agency also participates in the Rosedale Rio Bravo Water Storage District Water Banking and Exchange Program. CLWA has entered into a long-term agreement with RRBWSD that provides for the total storage of 100,000 AF at any given time and annual storage and withdrawal 20,000 AF. The Agency paid \$6 million of upfront storage fees. The agreement also provides the Agency the option of constructing up to seven additional wells to enhance that extraction capacity. In 2010, the Agency provided RRBWSD notice of its intent to construct three wells and the associate conveyance facilities. The

estimated cost of these facilities is \$1.5 million. These capital costs have been funded from past and existing capital funds.

The extraction cost of the water from the program is estimated at \$30 an acre-foot plus energy costs and conveyance costs – that is, \$3 million in extraction costs plus energy and conveyance costs. Overall, the cost of recovering water from this program is similar to the Semitropic program. Because of the shorter term of the Semitropic program, the Agency would most likely prioritize withdrawals from that program. *A funding source has not been identified for these operational costs.*

### ***Emergency Storage Programs***

The Agency's 2009 Water Supply Reliability Plan Update also identifies the need for emergency storage to be available meet water demand should outages occur on the State Water Project. The most challenging scenario for the Agency would be an outage of the West Branch of the California Aqueduct caused by an earthquake. The reliability report recommends the Agency have in place approximately 5,000 AF of storage in place in the near term and about 14,000 AF available by 2050 South of the Tehachapi Mountains. Identification of storage opportunities south of the Tehachapi Mountains is identified as a Fiscal Year 2011/12 Action item and implementing an initial emergency storage program would be anticipated in the near-term. *It is anticipated such a program would have significant capital and operational costs, and a funding source has not been identified.*

## **STATE WATER CONTRACT FUND (Mid-term)**

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The Agency funds the State Water Project (SWP) contract commitment through the ad valorem tax rate. Due to legal and regulatory restrictions on water exports, the Agency is facing reduced SWP reliability and increased SWP costs. As various parties look to a Delta fix (Bay Delta Conservation Plan [BDCP] and the Delta Habitat Conservation and Conveyance Program [DHCCP]), costs are anticipated to increase significantly. The cost estimates for a Delta fix exceed \$12 billion. Assuming current Delta exporters all participate in a Delta fix, the Agency's share of this cost would be about 1.5 percent of the DHCCP cost. Further cost increases are anticipated as the cost of energy increases for the SWP with the expiration of existing energy contracts. Additionally, as the SWP ages, many components will require replacement. The Agency is incurring significant increases in the Agency-set tax rate, due to increasing costs and due to decreased assessed valuations. It is likely that the tax rate will continue to increase even when assessed valuations increase due to the BDCP and DHCCP.

The Agency will continue to monitor SWP expenditures and strive to provide consistent changes in ad valorem tax rates.

## **SECURITY (Long-term)**

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The Environmental Protection Agency (EPA) states that improving the security of our nation's drinking water and wastewater infrastructures has become a top priority since the events of 9/11. The EPA requires water agencies to engage in a number of security programs. In 2003, the Agency prepared an EPA-mandated risk assessment, or a Vulnerability Assessment. As a result, the Agency is implementing security improvements using a phased approach. As new facilities are constructed, the security system will become more complex and more challenging to operate, which will result in increased operating and maintenance costs. At this time, the Agency spends an extremely small portion of its operating and capital improvement budgets on security measures. It is likely that the financial impact of security will increase over time. This will increase operating and capital improvement program costs.

