Aquarius Utilities, LLC

"At Your Service"

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Memorandum

February 29, 2016

To: Amy White, WUTC
Jim Ward, WUTC

From: Greg Roats

Re: Proposed Surcharge Adjustment

Since our last meeting, I have re-worked the DWSRF loan repayment schedule to reflect actual conditions through 12/31/15 and revised projections through 2028, when the loans mature. The new spreadsheet is attached for reference, along with the original table that was included in the 2008 surcharge tariff.

I have expanded the Number of Customers Added column into 4 columns to provide a more complete picture of the various forces which have influenced the numbers. I have also added a column at the far right which gives the annual funding shortfall (funds collected minus loan payment). A description of each column is as follows:

1. **Year:** Calendar year. The DWSRF loan contracts run from 2008 through 2028.
2. **By New Connection:** Number of new connections added during year; includes connections installed during year but paid for in a prior year.
3. **Services Removed:** Service connections removed during year, either by customer request or due to long term non-payment. 15 services have been removed to date since 2008.
4. **By Other Means:** Customers added administratively; e.g., 43 customer accounts which had previously been "inactive" for billing purposes were re-added in 2009 and henceforth billed the minimum monthly charge, plus the surcharge amount.
5. **Net Number Added:** Total number of customers added for the year, taking service removals into account.
6. **Total Billed Customers @ Year End:** The number of customers billed, taken from the December billing for that year. The number of billings varies by up to 5 each month due to ongoing account changes, closings and openings.
7. **Facilities Charges.** The surcharge tariff required that facilities charges ($1475) be collected and deposited in the SRF bank account for each new service connection. The figure for each year includes those connections paid during that year; it does not include connections installed that year but paid for in a prior year.

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Description of columns (cont.):

8. **Company Owner Contribution:** Amount provided by the company owner annually to be deposited in the surcharge bank account, per the 2008 tariff. The $10,000 amount is almost 100 times the amount paid annually by a company customer.
9. **Surcharge Amount per Month:** The amount added to each customer's water bill every month for DWSRF loan payment. The 2008 surcharge tariff set the surcharge amount at $4.00 per month for 2008, then $8.70 per month from 2009 to the end of the loan period in 2028.
10. **Surcharge Revenue:** The surcharge revenue collected from customer billings and deposited each calendar year.
11. **Total Funds Collected (All Sources):** The total surcharge revenue collected from facilities charges, owner contribution and customer surcharge billings; the sum of columns 7, 8 and 10.
12. **Loan Payment:** The sum of loan payments for the four (4) DWSRF loans covered by the 2008 surcharge tariff. All 4 loan payments are due each year on October 1st. All the loans mature on the same date in 2028, unless paid in full at an earlier date.
13. **Loan Funds Balance @ Year End:** The net of all surcharge funds collected and deposited less the annual loan payment. The funds balance at the end of 2015 was $52,763, and the fund is projected to diminish to zero by the end of 2017. Using updated projections, if the customer surcharge were not adjusted, the fund deficit could be expected to reach $170,000 by 2028.
14. **Annual Funding Shortfall:** The total available loan funds at year end less the loan payment for that year. From 2016 to 2028, the average shortfall is projected to be $17,156 annually.

On the spreadsheet, a heavy black line is drawn under the 2015 figures to delineate historical actual figures above and updated projections below. The first 8 columns are totaled as of 12/31/15, while columns 10, 11 and 12 include projections and are totaled through 2028.

Comparing the new spreadsheet with the original, several differences stand out:

(1) **New connections**. The original connection figures were based on a strong growth rate of 1 percent. This was supported by historically aggressive growth during 2003 to 2007, as well as county population projections from the approved Water System Plan for each water system. However, the

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economic recession and associated meltdown of the housing/ real estate market, beginning in 2008, caused the new connection figures to collapse. In the new tabulation, the relatively high figures for 2008 and 2010 are misleading, as they were the result of connections paid for in prior years but not yet installed; only 3 facilities charges were actually collected in each of those years.

The other factor affecting the rate of new connections is availability of building sites. As infilling of lots has progressed in each service area, the desirable building sites, from the standpoint of lot size, soil suitability and topography, have already been built upon. As a result, the remaining lots are increasingly challenging and marginal as building sites. These lots become more expensive to develop and apply a braking force on customer growth.

Since 2008, the growth of new customers has limped along at a fraction of original projections, and we do not see any change in this trend going forward. This reality is reflected in the conservatively low projections for customer growth shown in the new spreadsheet, and underscores the fact that facilities charges have become and will likely remain a very minor source of loan repayment funds.

(2) **Number of Customers.** As a result of low growth rates, the total customer figures shown on the new and old tabulations are markedly different. At the close of 2015, the two tables were not that far apart: 930 vs. 943 for the new and old tables, respectively. However, due to the large differences in assumed growth rate, current projections place the number of customers in 2028 at 953, this is 121 customers short of the 1074 figure from the original table.

(3) **Facilities Charges and Surcharge Revenue.** The low growth rate and resulting low total customer count, per our new projections, will have a profound impact on both facilities charge revenue and surcharge revenue. This is apparent when columns 7 and 10 in the new spreadsheet are compared with the corresponding columns in the original table.

(4) **Loan Payment.** For the original tabulation, an aggressive schedule for drawdown of construction funds was assumed; thus the first full loan payment was shown to occur in 2010. In reality, however, the 3-year loan

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contract was extended by nearly one year, and construction funds were drawn down more gradually, with the final distribution occurring in summer 2012. Consequently, the first full loan payment did not occur until 2012, two years later than originally projected. Because the loan maturity date remained at 2028 under both scenarios, the bulk of the loan balances must be repaid over a shorter period. Thus, comparing the spreadsheets, the actual annual loan payments are $5000 to $8000 higher than originally estimated.

(5) **Loan Funds Balance @ Year End.** The original spreadsheet was based on strong growth rates, with correspondingly strong generation of facilities charges and surcharge revenues. As a result, the tabulation depicts an optimistic scenario for the loan account balance in which the number of customers reaches a "critical mass" which produces an increasing loan funds balance beginning in 2019.

Due to much slower growth, the real scenario is much different. As reflected in columns 13 and 14, the loan funds balance has been decreasing steadily and is expected to continuing to do so for the life of the loans. By 2028, the loan funds deficit is expected to reach $170,000, and the annual shortage of funds is expected to average more than $17,000 per year from 2016 to 2028.

Problem Summary

Due to a combination of aforementioned factors, collected surcharge funds have not and are not keeping pace with the annual loan payments. Actual economic conditions have rendered the original estimates unrealistic and inadequate. If the situation is not corrected, the shortfall in repayment funds will have serious negative impacts on operations of the company, affecting our ability to properly operate, maintain, and repair waterworks facilities, perform system upgrades, purchase equipment, and provide customer service.

Solution

During the 2008 surcharge rate case, commission staff indicated that, if growth and revenue estimates did not produce the revenue required to meet the loan payments, the company would be justified in requesting an adjustment in the surcharge amount to reflect actual conditions, and that approval would not be unreasonably withheld. We have calculated that an adjustment of $1.80 per month per customer, bringing the surcharge amount to $10.50, would generate an additional $20,000 annually. This amount would be sufficient to offset the projected deficits in loan repayment funds and preserve our ability as a utility to meet our obligations and continue our commitment to excellence in facility management and customer service.