



CITY OF SANTA BARBARA

COUNCIL AGENDA REPORT

AGENDA DATE: February 23, 2016

TO: Mayor and Councilmembers

FROM: Water Resources Division, Public Works Department

SUBJECT: Reserve Management Policy Direction For The Fiscal Year 2017 Water Rate Study

RECOMMENDATION:

That Council receive a presentation and provide direction on assumptions for the Fiscal Year 2017 Water Rate Study, specifically for the planned reserves management during continued drought conditions.

DISCUSSION:

On November 24, 2015, Council authorized the Public Works Director to execute a City Professional Services contract with Raftelis Financial Consultants, Inc. (Raftelis), in the amount of \$50,221 for the development of the Fiscal Year 2017 Water Rate Study (Study), and authorized the Public Works Director to approve expenditures of up to \$12,555 for extra services that may result from necessary changes in the scope of work.

The Study is being developed in preparation for continued drought conditions. The proposed Fiscal Year 2017 water rates will be structured to continue incentivizing reduction in customer water use to ensure that planned demand reductions are achieved. After the typical rainy season is over this spring, the water supply outlook and conservation target will be re-assessed. It is anticipated that the conservation target will increase, should dry conditions persist. Water rates are preliminarily being designed based on current conservation levels. If the water supply conditions improve, water rates can be adjusted accordingly prior to adoption.

Continued drought conditions could result in additional drought related expenses for supplemental water purchases, conveyance of State Water through Lake Cachuma, and extended full-production operation of the desalination facility. The financial plan is being developed with the assumption that these drought related costs will be necessary through Fiscal Year 2018. If the water supply condition improves, water rates can be adjusted accordingly prior to adoption.

Reserve Management Scenarios

As of June 2015, reserve balances were approximately \$17.3 million (including \$5 million from the Rate Stabilization Fund). Projected use of Fiscal Year 2016 reserves is approximately \$2.9 million (based on use of reserves of \$6.4 million for adopted Fiscal Year 2016 budget, net additional \$3.5 million revenue from grants/reimbursements), resulting in a projected balance of \$14.4 million on June 30, 2016. Under adopted reserve policies, the Water Fund Policy reserves should total approximately \$18.3 million in Fiscal Year 2016. Reserves are anticipated to be \$3.9 million below policy at the end of Fiscal Year 2016 assuming all drought-related expenditures budgeted for Fiscal Year 2016 are spent as a result of ongoing drought.

Two reserve management scenarios are being proposed for discussion:

Scenario 1 – No Use of Reserves, and Short-Term Reserve Recovery: The first scenario assumes no use of any reserves to meet projected expenses for the four-year financial period starting in Fiscal Year 2016. This scenario assumes that all projected expenses will be met entirely with revenues recovered from water rates, and the water rates would generate revenue to restore the reserve balance to policy levels within a one-year period.

Scenario 2 – Some Use of Reserves, and Longer-Term Reserve Recovery: In this scenario, reserves are used for one-time drought expenses, and the reserve balance is planned to return to policy targets over a three-year period.

Preliminary results show that projected increase in revenue requirements range between approximately 16-36 percent for Fiscal Year 2017, depending on reserve management; however, the analysis continues to be refined.

Given the volatility in water demands and supply conditions, staff does not recommend water rate planning that assumes a drop of reserves below Council policy. Staff recommends the first scenario, in which rate planning is developed with the assumption that total reserve funds remain equal to or above Council policy.

Debt Service Coverage Requirements

The Water Fund is the dedicated source of revenue for the Series 2013 Water Revenue Refunded Certificates of Participation, the Central Coast Water Authority (CCWA) Water Supply Agreement for costs associated with the State Water Project, two State Revolving Fund ("SRF") loans for the Cater Treatment Plant (2010 and 2002) and, as of Fiscal Year 2016, the SRF loan for the reactivation of the Desalination Plant. With the exception of the 2002 Cater SRF loan which is subordinate debt, all other Water Fund debt are parity debt obligations. All of the parity debt obligations contain a covenant that the Water Fund must maintain a debt coverage ratio of 125% of total debt service on all parity obligations. The debt coverage ratio is calculated by dividing the net operating revenue by the total debt service. For Fiscal Year 2015, the Water Fund debt coverage ratio for parity debt obligations was 110% and for the subordinate debt obligation the ratio was 0.76%. The

debt coverage ratio fell short of the requirement as a result of lower revenues than projected (due to lower water usage), as well as a water rate model assumption that fixed costs associated with the CCWA Water Supply Agreement were to be treated as operating expenses rather than debt service. The Fiscal Year 2015 debt coverage ratios will be disclosed to the City's lenders to be part of the City's required continuing disclosures.

For development of Fiscal Year 2016 water rates, and going forward, the rate model assumptions were changed such that fixed costs for the Water Supply Agreement are now considered debt service. This correction is expected to result in the City meeting its debt coverage ratio in all scenarios considered for Fiscal Year 2017 water rates development, as long as revenues are not significantly lower than projected.

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