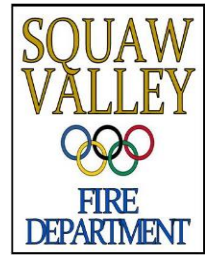




SQUAW VALLEY PUBLIC SERVICE DISTRICT



PROFESSIONAL SERVICES AGREEMENT WITH HDR ENGINEERING, INC.

DATE: July 28, 2015

TO: District Board Members

FROM: Tom Campbell, Finance & Administration Manager
Mike Geary, General Manager

SUBJECT: Rate Study Project-Professional Services Agreement with HDR Engineering, Inc.

BACKGROUND: Proposition 218 requires a utility to establish cost-based rates for the services provided. In 2004, The District retained Economic and Engineering Services, Inc. (EES) to review the water rate designs and provide alternative options to meet the District's objectives. The District has implemented some recommendations from this rate design, and continues to utilize an evolved version of the rate methodology to establish current rates.

The District's connection fees have not been analyzed and updated since 2007, nor have they been adjusted for inflation. With a plethora of development occurring and about to occur within the District's jurisdiction, an updated analysis of connection fees and operating capacity should be performed to reflect a present cost of connecting to the District's utility infrastructure.

Further scrutiny needs to be performed regarding how the capital replacement of assets will impact rates, in addition to determining equitable distribution of rates among customer classes (residential, multi-unit, commercial, and irrigation).

The District's 5-Year Strategic Plan section 1.3.0 states the goal to "Apportion costs and benefits fairly among the water supply users", and specifically "Perform update of Capital Replacement Program" (Section 4.1.0), "Implement a Work Order System to track operating expenses by department to determine the cost of each service provided. Use data to accurately set rates and assessments that correlate to the levels of services provided" (Section 4.2.0), and "Update Water Plant Availability Charge (PAC) Fees and Connection Fees" (Section 4.3.0).

DISCUSSION: The District received the attached proposal from HDR Engineering, Inc. (HDR) for \$48,675 to review the cost of services and related revenue requirements for water and sewer, in addition to reviewing the structure of the District's water and sewer connection fees.

HDR will determine the revenue requirements for water and sewer based on a 10-year analysis of costs to operate the District's water and sewer systems, in addition to the anticipated reserves based on the District's capital replacement needs.

Further scrutiny by HDR of the District's tiered water structure is essential to validate the District is operating within its legal authority and industry best practices.

HDR will further analyze the District's water and sewer connection fees by assessing existing plant capacity, in addition to the impact of future proposed development.

The resulting analysis will provide the District with a current rate and fee structure, which will be equitable amongst all customer classes, and take into consideration capital replacement projects. Staff plans to utilize this analysis and structure to publish a 5-year rate plan to be distributed with the next Proposition 218 notice during spring 2016.

The District has selected HDR due to the efficiencies that come with the HDR team's experience working with the District in the past, in addition to other peer agencies within the region. The supervising members of the HDR project team were also project members of the team that originally established the foundation of our present rate structures in 2004 (EES was acquired by HDR on or about September 2004). As such, the District is anticipating savings resulting from less time for the consulting team to orient themselves with the District's structure, in addition to orienting themselves to any specific issues prevalent in the Lake Tahoe region. The level of quality of deliverables presented by HDR has also been praised by regional peer districts. Further benefits of this project include the HDR's team accommodative schedule.

The 2015-16 Capital Budget allocated a total of \$25,000 split equally between the water and sewer capital accounts to fund this project. At the time of budget preparation, this amount was underestimated and did not take into account an analysis of connection fees, and a comprehensive review of sewer rates. Staff is further requesting a budget amendment to increase the total budget for this project to \$48,675, equally apportioned between the water and sewer capital accounts.

ALTERNATIVES:

1. Approve proposal as presented and amend budget accordingly
2. Reduce scope of work of presented proposal and amend budget accordingly
3. Decline the proposal

FISCAL/RESOURCE IMPACTS: Project costs will be split evenly between Water and Sewer Capital. Approved 2015-16 Budget currently has \$25,000 earmarked for this project, and staff is requesting a Budget Amendment for an additional \$23,675 for the full amount of the attached proposal.

RECOMMENDATION: Authorize the General Manager to execute the HDR proposal and contract as presented.

ATTACHMENTS: HDR Engineering Proposal and Scope of Work (18 pages)

DATE PREPARED: July 17, 2015

1. Scope of Work

Introduction

The Squaw Valley Public Service District (District) has requested assistance from HDR Engineering, Inc., (HDR) to develop cost-based rates and connection fees. The development of the water and sewer rates will be based on the sufficient funding of operating and capital needs over the time period reviewed (i.e., 10 years). A key component of this will be incorporating the District's fixed asset replacement funding needs for each utility. The review and development of the connection fees is based on the cost of the District having developed the infrastructure, and resulting capacity, for new customers to be able to connect to the system and receive service.

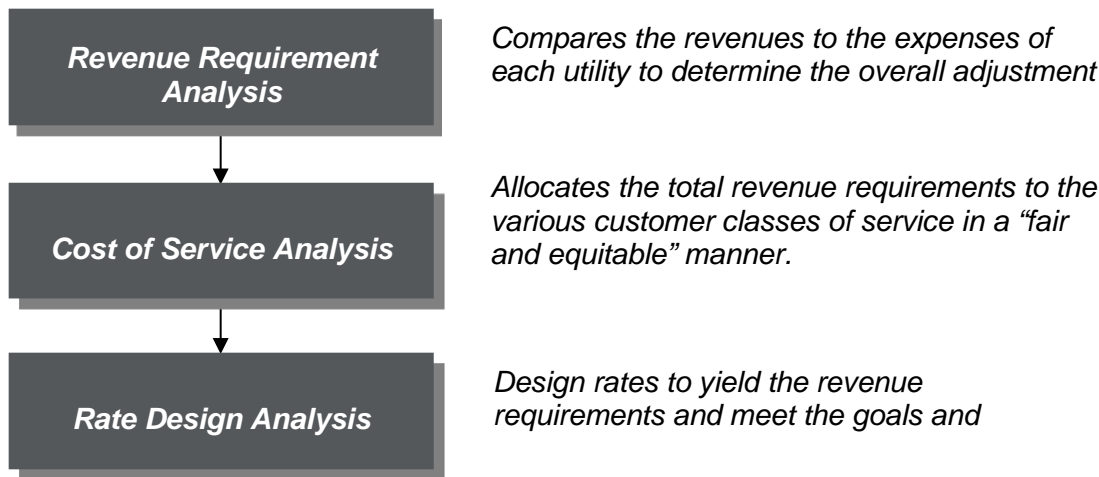
The development of water and sewer rates that meet the legal requirements (e.g., Proposition 218) is paramount. At its very core, Proposition 218 requires a water utility to establish cost-based rates for the services provided. However, like most propositions or voter's initiatives, Proposition 218 provided certain direction, but lacked clarity and definition in certain areas. Hence, there have been a number of lawsuits in recent years related to utility rates and Proposition 218. In the *Capistrano Taxpayers Association v. City of San Juan Capistrano*, the City of San Juan Capistrano (City) was challenged, among other items, over the cost-basis for the tiers (price blocks) of their tiered water rate structure. The initial ruling of the court in this case was not favorable to the City and the City appealed the court's decision. Most recently, the Appeal Court hearing this case upheld the lower court's decision as it pertained to the pricing of the tiers within the City's water rate design. In summary, the Appeal Court ruled that tiered rates are a valid rate structure, but the pricing of the tiers must be cost-based.

HDR has developed the following scope of services to provide the District with a projection of cost-based and equitable rates and fees for its water and sewer utilities. The results of this study will provide the District with water and sewer rate transition plans to meet the District's operating and capital needs. The results of the water and sewer rate studies will be communicated to the District staff and management through a written report and presentations to the District's Board

Overview of a Comprehensive Rate Study

In reviewing the District's water and sewer rates, each utility will be reviewed on a "stand-alone" basis. This allows the District to gain a better understanding of the costs associated with each utility. At the same time, the methodology HDR typically uses for its comprehensive rate studies relies upon "generally accepted" methodologies within the financial and rate-setting industry. A comprehensive rate study is generally comprised of the three interrelated analyses shown below in Figure 1-1.

Figure 1-1
Overview of the Comprehensive Rate Study Process



While Figure 1–1 provides an overview of the typical components of a comprehensive rate study, an important aspect of this study is incorporating and “tailoring” those analytical elements into an overall scope of services. The scope of services developed for the District will provide a comprehensive rate analysis.

Scope of Services

HDR’s proposed scope of work is divided into several interrelated tasks. HDR’s scope of work is based upon “generally accepted” rate and fee setting methodologies, HDR’s understanding of the District’s past rate setting practices, and current industry “best practices” and trends.

A discussion of the proposed scope of services and the interrelated tasks is provided below.

Task 1 - Initial Project (Kick-Off) Meeting and Data Collection

Task Objective: *Bring the HDR project team and District management and staff together, at the start of the project, to allow the parties to have a mutual understanding of the goals, objectives, issues, and concerns related to the study. Gather and review the data and information needed to conduct the water and sewer rate and connection fee studies.*

The initial project (kick-off) meeting is important to the overall success of the rate study process. This meeting allows both parties to discuss the overall goals and objectives for the studies, while at the same time discuss issues and concerns that either party may have. A written data request will be provided to the District prior to the kick-off meeting to allow for the gathering of data and discussion during the meeting. It is proposed that this meeting be held via a conference call and/or web meeting and be approximately two hours in length.



EXPECTED DISTRICT SUPPORT FOR TASK 1:

- Have key management/project team members participate in up to a two-hour kick-off meeting.
- Review and confirmation of the District's goals and objectives for the study.
- Provide the needed data and information from the data request.

DELIVERABLES AS A RESULT OF TASK 1:

- Written data request detailing the needed data and information.
- Kick-off meeting conference call to get the study off to a positive start.
- Identification of objectives, issues, and concerns by both parties.
- Review and confirm scope of work and general approach.

Task 2 - Revenue Requirement Analysis

Task Objective: *Using “generally accepted” financial planning methodologies, develop the District’s water and sewer revenue requirement analyses for a projected 10-year period. The revenue requirement analyses will establish the cost-based ‘level’ of revenue to be collected from customers to prudently fund the water and sewer utility operating and capital expenses. As necessary, develop a rate transition plan to move toward cost-based levels.*

The development of the revenue requirement analyses is the first major analytical portion of the water and sewer rate study process. This portion of the study entails reviewing the various sources of funds (revenues) and comparing them to the applications of funds (expenses) for each utility. This task considers the prudent and proper funding for operations and maintenance (O&M) and capital expenditures and determines the need for rate adjustments over the time period selected. A more detailed discussion of the various steps involved in developing the revenue requirements is provided below.

“This task considers the prudent and proper funding of O&M and capital expenditures . . .”

STEP 1 – SELECTION OF A TEST PERIOD: The first step in the development of the revenue requirements is the selection of a “test period”. In this case, a 10-year test period or projected time period is proposed (e.g., FY 2016 – FY 2025). By reviewing costs over this extended time frame, the District can determine when major rate adjustments may be required and potentially take steps today to help minimize future impacts (e.g., rate adjustment transition, accumulation of capital reserves, etc.). However, the focus of the study will be the next five-year period for rate setting to align with the requirements of Proposition 218. The final test period can be determined during the initial project meeting.

STEP 2 – METHOD OF ACCUMULATING COSTS: Once the “test period” has been determined, the next decision is to determine the basis or method of accumulating costs. There are two choices for accumulating costs for revenue requirement/financial planning purposes: “cash” or “utility/accrual” basis. The “cash basis” methodology is the most commonly used methodology

by public utilities and is the methodology proposed for the water and sewer rate studies, and is the method used in the District’s past rate models.

STEP 3 – ACCUMULATION OF REVENUES AND EXPENSES: Once the test period and method of accumulating costs has been determined, HDR, in conjunction with District management and staff, will develop the test period revenue requirements for the water and sewer utilities.

Revenue requirements are composed of two major types of costs: operational and capital. The operational costs are generally projected from historical or budgeted costs, using assumed escalation factors, and adjusted for known changes in operations (e.g., additional personnel, growth/expansion, etc.). While the projection of the operational costs is fairly straightforward, the capital cost projections are generally the focus of the analysis, and requires more thought and planning.

Within this study, the starting point for projecting capital costs (expenditures) will be the District’s water and sewer capital improvement plans. In addition, the District has a long-term fixed asset replacement plan that will be used to develop a funding analysis to meet future infrastructure replacements.

“In the financial planning process, consideration must be given to maximizing the capital improvements (expenditures) for each utility, while minimizing rates to its customers.”

In the financial planning process, consideration must be given to maximizing the capital improvements (expenditures) for each utility, while minimizing rates to customers. This is accomplished in a variety of ways. However, the most important aspect of this discussion is that there are multiple methods of financing capital expenditures and it is through this process that rates can be minimized. Table 1-1 provides an overview of the general approach that is used to develop a capital funding plan within the revenue requirement analysis.

Table 1-1
Overview of the General Methodology for Reviewing
the Financing of Capital Project Expenses

- + **Total Capital Projects –**
 - ✓ Renewal and Replacement Capital Projects
 - ✓ Legally Mandated Capital Projects
 - ✓ System Growth and Expansion Capital Projects
- **Outside Funding Sources –**
 - ✓ Capital Reserves
 - ✓ Grants
 - ✓ Low-Interest Loans (e.g. State and/or Federal)
 - ✓ Contributed Capital
 - ✓ Borrowed Funds/Long Term Debt (e.g., Revenue Bond)
- = **Capital Projects Financed with Rate Revenues (≥ Depreciation Expenses)**

The basic framework shown above is developed on a year-by-year basis for each of the projected 10 years. In summary form, the general approach is to list capital projects in each year, and then determine the various outside funding sources for each of the projects. These outside funding sources may be low-interest loans, grants, customer capital contributions, etc. The balance of projects not funded by the available sources of funds must be financed from a combination of long-term debt and rates. It is the balancing of the use of long-term debt to the impact upon rates that is critical to the analysis.

In balancing the use of debt¹ to equity (rate) financing of capital projects, a number of financial planning aspects are taken into account. First, the utility's debt service coverage ratio is an important financial measure or indication of the utility's ability to repay debt. The strength of the debt service coverage ratio is a direct function of the level of capital projects that are financed from rate revenues. A simple financial test that HDR utilizes is that a utility should fund, at a minimum, an amount equal to or greater than the utility's annual depreciation expense for renewal and replacement capital projects. By following this simple financial rule, the utility is not only establishing a potentially strong debt service coverage ratio, but at the same time, it helps provide consistent funding to maintain existing infrastructure at acceptable service levels, with minimal or no long-term debt financing. This level of rate funded capital will also take into consideration the District's fixed asset replacement needs and the establishment of a reserve fund to finance future replacements.

In summary, given a better understanding of the overall magnitude of the needed capital projects, a final financing plan can be developed that meets the District's goals and objectives, while attempting to minimize rates and costs over time. At the same time, if a rate adjustment transition plan is needed, it will be developed.

EXPECTED DISTRICT SUPPORT FOR TASK 2:

- Provide "as needed" assistance to explain the District's data and information as it relates to developing the revenue requirements.
- Provide "as needed" data refinements or additional data needs as determined during the process of developing the revenue requirements.
- Provide the annual fixed asset replacement needs and model.
- Attend a one-half day project meeting to review the draft revenue requirement analysis to review the overall methodology and confirm all model assumptions and key inputs.

DELIVERABLES AS A RESULT OF TASK 2:

- A water and sewer revenue requirement analysis for a projected 10-year period that considers the prudent funding of operating and capital needs of each utility.

¹ Within this study, HDR is not acting as a financial advisor (i.e., municipal advisor) regarding the issuance of long-term debt. The District has a financial advisor to fulfill this municipal advisory role as it relates to the size, timing, and structuring of proposed debt issues.



- A capital financing plan within the revenue requirement analysis based on the current capital budgets and fixed asset replacement needs of each utility.
- As necessary, a transition plan to “phase in” needed rate adjustments.
- Review of the debt service coverage ratios to meet bond covenants.
- Recommendations regarding other key financial indicators (e.g., capital replacement, reserve levels).
- Project meeting at the District’s location to discuss the development of the revenue requirements and recommendations.

Task 3 - Cost of Service Analysis

Task Objective: *Develop an average embedded cost of service study for the water and sewer utilities to equitably allocate the revenue requirements to the customers served by the District. Develop a methodology that equitably allocates the costs to customers, while considering the varying levels of service (e.g. single-family, multi-family, irrigation, commercial)*

Given the results of the revenue requirement analysis, they will be allocated to the various customer classes of service using an average embedded cost of service methodology. A cost of service analysis will be conducted for both utilities. In simplified terms, a cost of service study attempts to equitably allocate the revenue requirements between the various customer classes of service (e.g., residential, non-residential, etc.). The water cost of service analysis and this particular task has taken on a higher level of importance since the last comprehensive rate study was conducted. It has always been important for a utility to have cost-based rates that are fair, equitable, and defensible. The basis for establishing water and sewer rates that are fair, equitable, and defensible has traditionally been cost of service principles and methodologies.² At the same time, the courts have historically recognized that municipal entities can take into account policy items other than strictly cost of service when establishing rates (e.g., conservation, efficient use, ability to pay, revenue stability, etc.).

The State of California has certain well established legal constraints regarding utility ratemaking, of which Proposition 218 is at the forefront. At its very core, Proposition 218 requires a water utility to establish cost-based rates for the services provided. However, Proposition 218 provided certain direction, but lacked clarity and definition in certain areas. Hence, there have been a number of lawsuits in recent years related to utility rates and Proposition 218. In the *Capistrano Taxpayers Association v. City of San Juan Capistrano*, the City was challenged, among other items, over the cost-basis for the tiers (price blocks) of their tiered water rate structure. The initial ruling of the court in this case was not favorable to the City and the City appealed the court’s decision. Most recently, the Appeal Court hearing this case upheld the lower court’s decision as it pertained to the pricing of the tiers within the City’s water rate design. In summary, the Appeal Court ruled that under the requirements of Proposition 218 tiered rates

² Generally-accepted cost of service principles and methodologies are best defined and discussed within the American Water Works Association (AWWA) M-1 Manual, [Principles of Water Rates, Fees and Charges](#) and the Water Environment Federation (WEF) Manual of Practice 27 [Financing and Charges for Wastewater Systems](#).

are a valid rate structure, but the pricing of the tiers must be cost-based. This ruling has a direct impact upon the need to provide clear documentation of the cost-basis for the District's rates. This task is designed to specifically address this new legal requirement. In the past, the District's costs were allocated to classes of service (e.g., single-family, multi-family, irrigation, and commercial). In this study, the costs will still be allocated to the classes of service, but the costs will also be allocated to pricing tiers (e.g., Tier 1, Tier 2, etc.) of the District's water rate structures for each class of service.

A brief discussion of the major steps associated with the proposed water and sewer cost of service analysis is provided below.

STEP 1 – SELECTION OF TEST PERIOD: The first step of a cost of service is to select a time period for the allocation of costs. A cost of service analysis typically reviews a one-year period, or the period over which rates will ultimately be set. In the District's case, allocating the FY 2016 revenue requirements for cost of service purposes would appear to be appropriate, at this time. HDR will confirm this test period with the District at the start of the project during the initial kick-off meeting.

STEP 2 – SELECTION OF THE METHOD TO ACCUMULATE COSTS: Much like the discussion of revenue requirements, the District must determine whether to use a "cash" or "accrual" basis approach for the cost of service study. HDR will verify the appropriateness of using the "cash basis" methodology with the District at the initial project meeting, but this is the methodology that the District has historically utilized for the studies.

STEP 3 – FUNCTIONALIZATION AND CLASSIFICATION OF EXPENSES:

The next step in the cost of service analysis is to functionalize the data. Functionalization refers to the arrangement of cost data into its basic cost categories. For the water utility, these typically take the form of source of supply/production, treatment, transmission, distribution. For the sewer utility, functionalization will include collection only as the District's sewer effluent is treated and pumped out of the Lake Tahoe Basin by the Tahoe-Truckee

"In simplified terms, a cost of service study attempts to equitably allocate the revenue requirements between the various customer classes of service."

Sanitation Agency (TTSA). This task is simplified greatly through the District's use of a uniform system of accounts for each utility. Given functionalized costs, the costs are then classified to their various cost components. Classification for the water utility involves determining whether each specific cost or account item was incurred to meet a consumer's capacity, commodity (flow), customer or fire protection related need. Classification for the sewer utility involves volume and customer related needs. Classification will be based upon "generally accepted" cost of service techniques and the District's specific system and customer characteristics.

STEP 4 – DETERMINATION OF CLASSES OF SERVICE: Development of the cost of service begins with determining the classes of service that will be used for purposes of establishing cost allocations and rates. The process of establishing classes of service is to group customers into homogeneous groups. That is, customers with similar usage and/or facility requirements.

As a part of this task, HDR will work with the District to review the customer classes of service within each cost of service analysis. However, as noted above for the water utility, the

Capistrano decision will require some additional refinement in the allocations to be able to demonstrate the cost-basis for any pricing tiers.

STEP 5 – ALLOCATION OF EXPENSES: The next analytical process involved in the cost of service study is the allocation of the classified expenses to each of the customer classes of service. Once the classes of service have been determined, the process of developing allocation factors is undertaken. In developing the allocation factors, HDR will develop factors that are “equitable” to all customers, and which rely upon District specific data and customer characteristics.

STEP 6 – SUMMARY OF THE COST OF SERVICE: Given the development of the allocation factors, the previous step allocated the expenses to each class of service. From this process, a summary page of the cost of service study is provided. The summary page for the cost of service study compares the difference between the current level of rate revenues received from each class of service, and the allocated cost of service for each class. This provides the District with an understanding of the relationship between the costs each customer class of service places on the system and the revenues received from the customers. From this analysis, the District can make a determination on rate adjustments that reflect customer class of service impacts on the system.

“The summary page for the cost of service study compares the difference between the current level of rate revenues received from each class of service, and the allocated cost of service for each class.”

The cost of service will also provide average unit costs, or cost-based water and sewer rates, for each customer class service. Average unit costs are important in that they are used as the starting point for the development of final rate designs. Average unit costs provide the District with an understanding of the cost/rate relationship between fixed and variable costs, but in this case, they will also provide the cost basis for the water rate tiered pricing. From this cost-based information, it can be combined with the District’s rate design goals and objectives to produce the final proposed rates for the District (Task 5).

EXPECTED DISTRICT STAFF SUPPORT FOR TASK 3:

- Attend a half-day project meeting to review the findings and results of the water and sewer cost of service analysis.
- Provide “as needed” data refinements or additional data needs as determined during the process of developing the cost of service analysis.
- Assist in the review of the tiered pricing methodology and analysis.

DELIVERABLES AS A RESULT OF TASK 3:

- Review of the current customer classes of service and determine revisions for cost allocation purposes.
- An equitable allocation of the revenue requirements to the various classes of service for the District’s water and sewer systems.
- A water and sewer cost of service allocation method that recognizes the various service levels of the District’s customers.

- A summary of the average unit costs (cost-based rates) for the various customer classes of service.
- Project meeting at the District's location to discuss the development of the revenue requirements and recommendations.

Task 4 - Development of the Water and Sewer Connection Fees

Task Objective: *Review the District's water and sewer connection charges and provide updated and cost-based connection charges for each utility based on the District's system values and planned capital improvements related to capacity expansion to serve the demands of customer growth.*

Connection fees are capital recovery fees generally established as one-time charges assessed against developers or new customers connecting to the system as a way to recover all or a part of the cost of additional system capacity constructed for their use. A connection fee is typically established based upon the value of each utility's capacity and the amount of capacity needed to serve the new customer. The objective of these fees is to bring equity between existing and new customers. The development of cost-based connection fees is also important from the perspective of the overall financial stability of the utilities. Connection fee revenue is used to finance growth-related infrastructure. As a general philosophy, most utilities prefer to have "growth pay for growth." This statement implies the development and implementation of cost-based connection fees.

Interestingly, there are a number of different methodologies that may be used to establish connection fees³ HDR will utilize their foundational understanding of these different methodologies and apply the appropriate methodologies based upon the specific circumstances of each utility (e.g., available excess capacity, no excess capacity/expansion needed, etc.). This task will review the methodology and approach used to establish the District's current connection fees. HDR will then update the connection fees to reflect current costs and the appropriate methodology that best reflects each utility's current condition and situation. More specifically, HDR will update the District's connection fees using each utility's assets, capital improvement needs, and financing data to determine cost-based connection fee for each utility. The connection fees must be developed to be in compliance with applicable California legal requirements. Draft connection fee results for each utility will be reviewed with District staff and finalized based on District input. Once the study is completed, the connection fee models will be electronically provided to the District. At the completion of the connection fee analysis, a separate report will be provided summarizing the approach, methodology, and recommendations of the connection fee analysis.

EXPECTED DISTRICT SUPPORT FOR TASK 4:

- Review and discuss the development of the current connection fee analysis for the water and sewer utilities.

³ For example, there are at least four different methods to value the District's assets. There are also three different methods for calculating connection fees: the buy-in methodology, incremental methodology, and combined methodology.

- Discuss the development of the appropriate connection fee methodology with HDR given the current system's capacity.
- Provide the future capital improvements related to providing new or additional capacity on the system.
- Review the development of the draft water and sewer connection fee analyses.
- Attend a project meeting to review and discuss the water and sewer connection fee analyses.

DELIVERABLES AS A RESULT OF TASK 4:

- Development of a cost-based water and sewer connection fee analysis.
- A written report detailing the development of the water and sewer connection fees.

Task 5 - Rate Design

Task Objective: *Develop water and sewer rate structure alternatives to meet the District's rate design goals and objectives, while complying with Proposition 218 requirements.*

Task 4 addressed the overall revenue sufficiency and determined necessary rate adjustments. Task 5 is designed to review the District's water and sewer rates—both the level and structure. Level refers to the amount of revenue to be collected from the rate design that is addressed as a part of the revenue requirement analysis. Structure refers to the way in which the desired level of revenue is collected. The development of fixed and variable charges will also be reviewed and discussed with the District.

An important starting point for the rate design process is understanding the District's rate design goals and objectives. These objectives may include conservation, revenue sufficiency, revenue stability, ease of administration, simplicity, etc. In designing the rate alternatives, each of the District's customer classes of service (i.e., single-family, multi-family, irrigation, and commercial) will be reviewed and appropriate water and sewer rate structure alternatives will be developed that reflect the District's overall rate design goals and objectives and current industry best practices, while reflecting the District's costs.

As noted previously, the recent *Capistrano* decision did not make tiered water rates illegal. Rather, the *Capistrano* decision stated that utilities must cost justify the pricing used in each tier. Failure to do so, at least under the current *Capistrano* decision, violates Proposition 218's requirement for cost-based rates. In the opinion of HDR, the court's decision has greatly diminished the policy input of the legislative body in establishing a local utility's rates.

Given these recent developments, the development of the District's tiered water and sewer rate structure alternatives will need to address the recent *Capistrano* decision. While there remains much discussion in the legal and rate community as to the impacts and stricter technical (legal) requirements as a result of the *Capistrano* decision, HDR has concluded that utilities have at least three technical approaches to be able to demonstrate (i.e., cost justify) the individual pricing of the tiers. Each will be reviewed and developed as applicable during the development

of the cost of service methodology (model) developed in Task 4. These technical approaches encompass the following areas:

- Cost differences in water supply (i.e., stacking of water supply resources to tiers).
- Cost differences from high peak use consumers (relationship of average use to peak use).
- Direct assignment of costs to specific (upper) tiers (e.g., conservation program costs, etc.).

This task will provide up to two alternative water and sewer rate structures for each of the District's customer classes of service to provide a cost basis for the District's rates. The District's current water rate includes a substantial tail block (final tier). This block and others tiers will need to be reviewed and the cost basis established for each tier. In addition, the District's current rates will be reviewed to determine how well they conform to contemporary rate-setting goals and objectives. For each rate alternative developed, a bill comparison and graph will be provided that shows a comparison between the present bill and the proposed bill at various levels of usage. Bill comparisons are useful in assessing the potential impacts to a wide variety of customers.

At the conclusion of this task, HDR will have developed rate design alternatives and provided a set of bill comparisons. From these alternatives, HDR will work with District staff and Board to establish a final proposed water and sewer rate structure for each customer class of service.

EXPECTED DISTRICT SUPPORT FOR TASK 5:

- Discuss with HDR the District's rate design goals and objectives.
- Assist, as necessary, in the development of the water and sewer rate structure alternatives and bill comparisons.
- Assist and review in the development of cost-basis for the tiered rate structure alternatives.
- Attend a project meeting to review and discuss the water and sewer rate structure alternatives.

DELIVERABLES AS A RESULT OF TASK 5:

- Up to three water and sewer rate structure alternatives for each customer class of service (i.e., single-family, multi-family, irrigation, and commercial).
- Development of bill comparisons for each of the rate structure alternatives developed.
- Development of the cost-basis for establishing tiered rate structure alternatives.
- A project meeting at the District's offices to review and discuss the water and sewer rate structure alternatives.

Task 6 - Written Report

Task Objective: *Provide a written report to summarize the findings, conclusions, and recommendations of the water and sewer rate studies.*

At the conclusion of the analysis, HDR will develop a draft written report. The report is intended to summarize the activities undertaken as a part of this project, along with our findings, conclusions, and recommendations. HDR will include a technical appendix of the analyses undertaken by HDR. HDR will provide an electronic copy of the draft report to the District for its review and comment. Comments, suggestions, or corrections from the District concerning the draft report will be incorporated into the final report. HDR will provide up to five bound copies and an electronic version in PDF of the final report.

EXPECTED DISTRICT SUPPORT FOR TASK 6:

- Review and comment on the draft written report.

DELIVERABLES AS A RESULT OF TASK 6:

- An electronic version of the draft written report.
- Up to five bound copies of the final written report.

Task 7 - Public Presentations

Task Objective: *Provide effective public presentations of the findings, results, and recommendations of the utility rate studies.*

The overall quality and value of a rate study is often measured by the quality of the public presentation process. In addition, the ability of the consultant to present this technical material in a manner that is easily understandable to the District Board and public is paramount. For planning purposes, HDR will assume attendance at two public presentations to assist the District staff in presenting the findings, conclusions, and recommendations of this study.

HDR will develop presentation materials for the public meetings and the HDR Project Manager will attend the public meetings. Meetings beyond the two proposed meetings will be provided on a time and material basis.

EXPECTED DISTRICT STAFF SUPPORT FOR TASK 7:

- Schedule and coordinate meeting dates and materials for the public presentations.
- Review and comment on proposed handouts for public meetings.

DELIVERABLES AS A RESULT OF TASK 7:

- Provide the presentation materials for the Board presentations.
- Up to two public presentations of the study's findings and recommendations.

Task 8 - Computer Models

Task Objective: *Provide a copy of rate models developed as part of this study.*

The financial/rate model(s) developed for the District will be provided at the end of the study. The model will be developed using Microsoft Excel. This task does not include user manuals or training in the use of the models.

EXPECTED DISTRICT STAFF SUPPORT FOR TASK 8:

- None.

DELIVERABLES AS A RESULT OF TASK 8:

- An electronic copy of the computer spreadsheet models used to develop the District's studies for each utility.

This concludes HDR's discussion of the proposed scope of services for the District's requested services. Additional out-of-scope work will be provided on a time and material basis. Out-of-scope work will only be provided with the written authorization of the District.

Summary

This section of the proposal has provided a detailed scope of services to provide technical and professional services as it relates to the District's water and sewer rates and connection fees. HDR has attempted to provide a detailed discussion of the proposed scope of services to demonstrate our understanding of the District's needs, while communicating our depth of knowledge and skill in this area.

2. Project Team

A key factor to the success of a rate study is the experience and expertise of the project team. To be successful, the project team must successfully combine a number of people with different backgrounds, experience, and abilities into a well-rounded, comprehensive team. We believe that is the strength of the proposed HDR project team. This section of our proposal will discuss our proposed project team for the District's study.

Key Project Team Members

Provided below is an overview of the individuals to be assigned to District's rate studies.

Shawn Koorn – Project Manager



- Assisted in the technical development and presentation of the 2004 water rate review for the District completed by HDR/EES.
 - More than 15 years of experience in utility rate setting, including revenue requirements, cost of service, and rate design
 - Recognized expert in the area of cost of service and rate design for utility rates.
 - Contributing author to the AWWA M-54 manual, Developing Rates for Small Systems.
-
- Project manager for several local water and/or sewer rate studies for Tahoe City Public Utility District, Truckee Donner Public Utility District, South Tahoe Public Utility District, Northstar Community Services District, and Alpine Springs County Water District.

Tom Gould – Quality Control



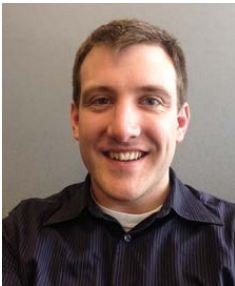
- More than 37 years of experience providing financial planning and rate studies for water, wastewater, and stormwater utilities.
 - Nationally-recognized expert in the area of cost of service and rate design for utility rates.
 - Conducted numerous water rate structure studies throughout California.
 - Was the project manager for the District's 2004 water rate review study completed by HDR/EES.
-
- Co-instructed the AWWA Financial Management seminar for more than 25 years.
 - Contributing author and member of the editorial committee of the recently updated sixth edition of the AWWA M-1 Manual, Principles of Water Rates, Fees and Charges, 2012.

Judy Dean, CPA – Senior Financial Analyst



- More than 16 years of experience performing water and sewer rate and fee analyses.
 - Assisted in the development of the technical analyses for Tahoe City Public Utility District, Northstar Community Services District, and South Tahoe Public Utility District.
 - Recently completed the connection fee analyses for the Lake Arrowhead Community Services District.
-
- Recently completed the technical analyses for recycled water connection fee for the City of Pleasanton.
 - Current Washington State Certified Public Accountant (inactive).
 - Prior to consulting, worked as a Finance Department Accountant for a municipality in Washington State.

Josiah Close – Financial Analyst



- Two years of experience in developing rate and fee models for water and wastewater systems.
 - Conducted the technical analyses for the Truckee Donner Public Utility District, Northstar Community Services District, and Tahoe City Public Utility District water and/or sewer rate studies.
 - Developed several rate design analyses to be in compliance with the recent *Capistrano* decision.
-
- Prior to joining HDR, worked for a Washington State agency doing financial analysis and budgeting.
 - Extensive experience in rate restructuring and analyzing customer data for purposes of establishing average winter water use, tiered usage blocks, and disaggregation/consolidation of classes of service

Summary

As can be seen, the HDR project team has many years of experience developing water and sewer rate and fee studies. The individuals noted above are available to begin working on this project immediately. Should other individuals be required for the District's studies, HDR has available a large number of other qualified individuals to meet any specific technical need associated with this study. The staff described above will be dedicated to the District's studies until its successful completion.

3. Schedule

Introduction

A rate study of this complexity generally requires 16 to 24 weeks to complete. However, for the District’s study, the analysis will begin in mid summer 2015 and the technical analysis completed early in 2016. The public presentation will occur in May and June of 2016. This is driven by other planning studies being developed for the District and the information being developed necessary to determine the appropriate level of operating and capital expenses in the studies.

Proposed Project Time Schedule

In discussions with the District the following schedule (see Figure 3-1) has been developed for the water and sewer rate and fee studies.

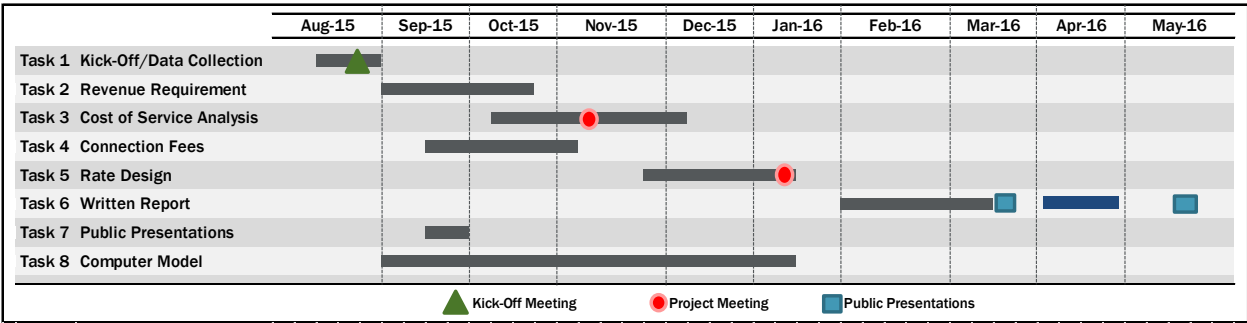


Figure 3-1. Project Schedule

As noted, the development of the water and sewer rate and connection fee analyses is dependent on the completion of other District studies. Given this, the schedule may adjust to reflect the completion of those studies to include relevant costs into the rate and fee studies. HDR will make every effort to meet the District’s desired time schedule for completion of the study. HDR will keep the District informed of the schedule and variation from it through direct communication with the District’s Project Manager and also within our monthly invoicing letter to the District’s Project Manager.

Summary

This section of HDR’s proposal has reviewed the proposed time schedule for completion of the District’s water and sewer rate studies. This time schedule has been developed based upon the previously presented scope of services.

4. Fee Schedule and Cost Proposal

Fee Schedule

Our proposed hourly rate schedule by job classification is provided below. These rates will be in effect over the course of this study, through 2016.

**HDR ENGINEERING, INC.
 RATE SCHEDULE**

Project Manager	\$240
Technical Advisor (QA/QC)	\$295
Senior Financial Analyst	\$170
Financial Analyst	\$110
Admin./Clerical	\$125

The billing rates shown cover payroll cost, employee benefits, and HDR overhead and profit.

EXPENSES

In-House Expenses

Technology Charge per Direct Labor Hour	\$3.70
Vehicle Mileage (per mile)	Current Federal Travel Regulation (FTR)
Black/White Photocopies (per copy)	\$0.05 to \$0.09
Color Copy (per copy)	\$0.15 to \$0.30

Please Note: Technology charges include computer, network, software, and other related technology services. No markup on expenses.

Cost Proposal

Table 4-1 on the following page shows our estimated work effort and cost anticipated for the project. HDR is willing to negotiate a final fee based on a final scope of services. Should the District request additional services under this contract, the services will be provided at the hourly billing rates stated above. Portions of this price proposal can be expanded or reduced in conformance with scope adjustments and as mutually agreed upon in writing by the District and HDR.

Table 4-1
Estimated Fees by Task and Project Team Member

Task	Task Description	Project Manager	QA/QC	Senior Analyst	Financial Analyst	Acct./ Admin.	Total Project
Hourly Billing Rates		\$240.00	\$295.00	\$170.00	\$110.00	\$125.00	
1	Kick-Off/Data Collection						
	Hours -	6	0	2	8	2	18
	Labor Cost	\$1,440	\$0	\$340	\$880	\$250	\$2,910
2	Revenue Requirement						
	Hours -	10	4	0	30	1	45
	Labor Cost	\$2,400	\$1,180	\$0	\$3,300	\$125	\$7,005
3	Cost of Service Analysis						
	Hours -	12	4	4	36	1	57
	Labor Cost	\$2,880	\$1,180	\$680	\$3,960	\$125	\$8,825
4	Connection Fees						
	Hours -	6	4	40	8	1	59
	Labor Cost	\$1,440	\$1,180	\$6,800	\$880	\$125	\$10,425
5	Rate Design						
	Hours -	12	4	6	24	1	47
	Labor Cost	\$2,880	\$1,180	\$1,020	\$2,640	\$125	\$7,845
4	Written Report						
	Hours -	4	4	0	12	2	22
	Labor Cost	\$960	\$1,180	\$0	\$1,320	\$250	\$3,710
7	Public Presentations						
	Hours -	10	2	0	4	2	18
	Labor Cost	\$2,400	\$590	\$0	\$440	\$250	\$3,680
8	Computer Model						
	Hours -	0	0	0	0	0	0
	Labor Cost	\$0	\$0	\$0	\$0	\$0	\$0
	Total Hours	60	22	52	122	10	266
	Total Fees	\$14,400	\$6,490	\$8,840	\$13,420	\$1,250	\$44,400
	Percentage of Hours by Employee	22.6%	8.3%	19.5%	45.9%	3.8%	100.0%
Expenses							
	Airfare (5 Round Trips @ \$350/RT)						1,750
	Hotel (2 Nights @ \$150/night)						300
	Rental Car (4 Days @ \$95/day)						380
	Parking/Meals/Miles/Etc.						495
	Printing/Copies						375
	Technology Charge						975
	Total Expenses						\$4,275
Grand Total Project Fee Estimate							\$48,675

Proposed Method of Payment

HDR proposes that fees will be billed monthly on a time and material basis in accordance with the unit prices described in the above price proposal.