

Addendum No. 2 to the 2019

Cost of Service and Rate Study

SANTA MARGARITA WATER DISTRICT

OCTOBER 2023

January 2024 Rate Update

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1 ADDENDUM NO. 2 EXECUTIVE SUMMARY

The Santa Margarita Water District (District) has developed this Addendum No. 2 to its Cost of Service and Rate Study dated November 2019 (2019 Study). The purpose of the Addendum is to update its potable water, recycled water, and wastewater rates effective on January 1, 2024, to ensure cost recovery, fund capital projects, and meet its Reserve and Fiscal Policy goals. The 2019 Study was developed based on cost allocation principles and requirements in accordance with California constitution article XIII D, section 6, commonly referred to as Proposition 218 and this Addendum does not amend those principles and requirements.

The 2019 Study covered a period of five Fiscal Years (FY), 2020 through 2024. The District enacted the customer rates contained in the 2019 Study for FY 2020 and FY 2021. Subsequently, an Addendum was prepared and approved in 2021 which provided a basis to update customer rates for FY 2022, FY 2023, and FY 2024. The District's financial results were generally in line with, or slightly exceeded, the 2021 Addendum expectations for Fiscal Years 2022 and 2023.

Subsequently, however, the District expects to incur significant variances from expectations for the upcoming FY 2024 expenditures. The January 2024 rate increase was established by the 2021 Addendum based on projections made in fall of 2021. This resulted in a 4.5% aggregate rate revenue increase. The FY 2024 Budget is indicated below, reflecting the variances as compared to the forecast in the 2021 Addendum.

Table 1-1 Financial Forecast Summary (\$1,000) – Water, Recycled Water and Wastewater Systems

REVENUE CATEGORY	FY 2023 ACTUAL	FY 2024 PRIOR FORECAST (1)	FY 2024 BUDGET	VARIANCE FROM PRIOR FORECAST
January 1 Aggregate Rate Increase %	4.5%	4.5%	4.5%	
Rate Revenue (with Increase)	\$82,531	\$90,564	\$90,889	\$325
Other Revenue	\$8,232	\$5,893	\$8,795	\$2,902
1% Property Tax	\$10,098	\$9,725	\$10,296	\$571
Total System Revenues with Rate Increase	\$100,861	\$106,182	\$109,980	\$3,797
EXPENDITURE CATEGORY	FY 2023 ACTUAL	FY 2024 PRIOR FORECAST*	FY 2024 BUDGET	VARIANCE FROM PRIOR FORECAST
Operating Expenditures	\$79,178	\$84,445	\$93,667	\$9,222
Debt Service	\$7,594	\$8,625	\$10,352	\$1,727
Total Expenditures	\$86,773	\$93,071	\$104,020	\$10,949
Plus: Connection Fee Revenues	\$4,204	\$2,260	\$1,892	(\$368)
Less: Purchased Assets	\$1,704	\$1,037	\$2,275	\$1,238
Net Available for Capital Expenditures	\$16,588	\$14,334	\$5,577	\$(8,757)

Notes:

- (1) Prior forecast contained in the 2021 Addendum.
 - Totals above may not sum due to rounding.

As indicated in the far-right column in the table above, the District's FY 2024 Budget includes \$8.7 million of total adverse variance to the 2021 Addendum, including the following key elements:

- **Inflationary Impacts.** The District has experienced cost increases in several areas over the past two years due to significant inflationary pressures. Notable areas include power, chemicals, vehicle fuel, general warehouse supplies, insurance premiums, and costs to purchase and treat drinking water. Combined, these areas are \$3.7 million higher than projected in the 2021 Addendum, or 5.2% of existing rate revenues.
- **Staffing Needs.** Total salary and benefit costs based on the FY 2024 Budget were \$4.5 million higher than projected by the 2021 Addendum, or 5.1% of existing rate revenues. The increases were primarily due to the need for new staffing positions in FY 2024 as well as a 6% cost of living adjustment to address inflation. Since 2021, new staffing needs have been driven by the acquisition of serving customers in the City of San Juan Capistrano, which increased the District's customers by approximately 20%, and a significant increase in new development projects in both the City of San Juan Capistrano and the newly constructed Village of Rienda.
- **Higher Other Revenues for Current Year Only.** While total system revenues are \$3.8 million higher than previously projected for FY 2024, this is almost entirely due to higher investment earnings. The higher investment earnings are expected to be limited to the current year only. The District projects to spend a significant portion of its reserves on capital projects (as planned). Further, short-term interest rates are elevated versus recent history and are likely to decline in the future.
- **Overall Impact: Lower Revenues Available For Capital Projects.** Overall, the District's FY 2024 Budget resulted in a total net impact of \$8.7 million compared to the 2021 Addendum, or a total of 13% of current rate revenues. While the District's revenues, even at the 4.5% previously assumed rate increase, can cover these operating cost increases for an interim period, planned revenues available for capital are significantly impacted.

Addendum No. 2 documents the District's plan to address these shortfalls in FY 2024 with a 9% overall rate revenue increase on January 1, 2024, while meeting its capital funding and financial policy goals.

Note on Scope of Addendum No. 2 and Chapters Updated

Addendum No. 2 documents changes in certain costs, customer demands, and other assumptions as they relate to rates effective January 1, 2024. As such, only Chapters 1, 3, and 4 of the original 2019 Study have been updated related to FY 2024 information only (these are re-numbered as Chapters 1, 2 and 3).

Addendum No. 2 does not contemplate any changes to the District's overall rate design, customer allocations, or functional and cost allocations established in the original Study from 2019. As such, Addendum No. 2 does not update Chapter 2 (Introduction), Chapter 5 (Cost of Service Analysis), or Chapter 6 (Rate Design). New rates are derived in the same manner as established in the 2019 Study based on updated information. Assuming the implementation of Addendum No. 2, the District's rates for the 5-year period covered by the 2019 Study will be established as follows:

January 1, 2020: 2019 Study (+3.9% rate increase)

January 1, 2021: 2019 Study (+4.5% rate increase)

January 1, 2022: Addendum to 2019 Study (2021) (+4.0% rate increase)

January 1, 2023: Addendum to 2019 Study (2021) (+4.5% rate increase)

January 1, 2024: Addendum No. 2 to 2019 Study (2023) (+9.0% rate increase)

FY 2024 Budget Cost Area Update

The table below documents the various operating cost increases in the FY 2024 Budget, as compared to the FY 2024 forecast contained in the 2021 Addendum.

Table 1-2 FY 2024 Budgeted and Projected Expenses (\$1,000) - Water, Recycled Water and Wastewater Systems

	Actual		Updated Projection	
	FY 2023 Actual	FY 2024 Prior Forecast	FY 2024 Budget	Variance
Water Purchases	\$27,051	\$30,898	\$31,133	\$235
Salaries & Benefits	\$23,513	\$23,248	\$27,651	\$4,404
Power	\$6,689	\$6,441	\$7,649	\$1,208
Other	\$21,926	\$23,859	\$27,234	\$3,375
Total	\$79,178	\$84,445	\$93,667	\$9,222

Note: Totals above may not sum due to rounding.

A summary of key cost areas in the FY 2024 Budget is as follows:

- Potable Water Purchases:** The Metropolitan Water District of Southern California (MET) increases its rates to the District by 6.0% for FY 2023 and 4% for FY 2024. Purchases of MET water currently comprises the majority of the District's potable water sources. Commencing in the mid-year of FY 2022, the District has been utilizing approximately 70% of the potable water produced at the San Juan Capistrano Groundwater Recovery Plant (GP), which increases water purchase costs on the first 1,600 AF utilized. However, such cost increases have been offset by the sharing of administrative costs with newly acquired customers. The District expects to maximize the production at the GP, ultimately providing the District with 3,200 AF of potable water at a lower cost than through MET.
- Recycled Water Purchases:** The District produces most of its recycled water in its own treatment plants, but it has also been purchasing recycled water each year from a few entities per long-standing agreements, RMV Mutual being the most prominent one (about 800-1,000 AF per year). With the closure of Oso Creek Water Reclamation Plant (OCWRP) since March 2022 (expected to be completed by December 2024), a reduction in our recycled water production will be supplemented through recycled water purchases from neighboring water districts, increasing the total purchase costs for recycled water.
- Salaries and Benefits:** The District's FY 2024 Budget includes 6.0% cost-of-living adjustment plus about \$2.4 million in new funding for proposed new positions and reclassifications of some existing employees. Additionally, costs for current-year pension benefits, known as "normal" cost, are projected to increase in FY 2024 as a result in an increase in the rate charged by CalPERS, due primarily to lower assumed long-term investment return on pension plan assets.
- Power Costs:** The District's electricity and gas costs are anticipated to increase 15% in FY 2024 with Southern California Edison and San Diego Gas & Electric making double digit rate increases. The District's power costs can be volatile due to both its own system and customer demands as well as pricing from the investor-owned utilities the District makes purchases from.
- All Other Operating:** Due to historical level inflation, expenses like chemicals, insurance premiums, supplies, etc. are all experiencing 10%+ increase in FY 2024.

Capital Improvement Funding Plan

The FY 2024 Capital Improvement Program (CIP) Budget provides the basis for the District's anticipated capital project needs for the coming year. The Budget included projects underway or expected to commence in FY 2024, with then net remaining total costs of \$205 million. At the time of Budget preparation, in March 2023, it was projected up to \$124 million would be spent in FY 2024. Based on the update for this Addendum, the District currently projects FY 2024 expenditures of \$106 million.

Table 1-3 Projected Capital Project Spending – From Rate Revenues and Revenue Bonds (\$1,000)

CIP CATEGORIES	FY 2024 REMAINING
Capital Repair and Replacement	\$41,365
Oso Creek Water Reclamation Plant - Optimization	\$39,078
Chiquita Water Reclamation Plant – Expansion and Upgrades	\$1,594
Water Supply and Reliability	\$17,954
Recycled Water Conversion and Conveyance	\$6,532
Total	\$106,523*

Note:

*Portions of net remaining project costs are projected to be incurred in FY 2025 and beyond.

Addendum No. 2 reflects the District's updated CIP funding plan, as outlined in the table below. In addition to existing sources of funding, the plan relies on \$9 million of current year net revenues (after the 9% increase), and issuance of new revenue bonds. The District also entered FY 2024 with approximately \$132 million in unrestricted reserves, with \$61.4 million planned for capital projects.

While current year operating costs are significantly higher than previously forecasted, the District has met its projections from the previous Addendum in terms of revenues and expenditures through the previous two years. This has permitted the District to build up unrestricted reserves planned for capital projects as previously contemplated.

Table 3-5 Projected Capital Improvement Program Expenditures (\$1,000)

	ADDENDUM UPDATED
	FY 2024
Total Capital Improvements	\$106,523
<u>CIP FUNDING PLAN BREAKDOWN</u>	
Other Funding Sources ⁽¹⁾	\$15,431
FY 2024 Net Revenues	\$9,231
Reserves Designated For Capital	\$61,269
New Revenue Bonds ⁽²⁾	\$20,592
Total Funding Sources	\$106,523

Notes:

(1) Includes: Grants, prior bond proceeds, and certain funds from other agencies.

(2) Portion of \$75 million of New Revenue Bonds required.

The funding plan is designed to meet the goals outlined in the District’s Reserve and Fiscal Policies (Policies) and is further outlined in Chapter 3. The Policies include two provisions which are critical to the District’s long-range financial planning and rate setting process. These include maintaining reserves equal to nine months operating costs, or 270 “days” of reserves and maintaining a debt service coverage ratio of at least 1.50x (the debt service ratio is calculated by dividing net revenues by total annual debt service).

UPDATED SUMMARY OF CUSTOMER IMPACTS

Customer Impacts – January 1, 2024

Overall, the proposed January 2024 rates are based on an aggregate rate-revenue increase of 9.0%. Impacts to customer bills, however, will vary depending on the type of customer and level of usage, as summarized in the table below.

Customer Type	Customer Count	Usage Pattern	Average Monthly Usage (ccf)	Current Total Monthly Bill	Total Bill After Increase	Monthly Increase \$	Monthly Increase (%)
Single Family Residential	38,000	Low User ~ 20%	5	\$76.4	\$80.7	\$4.3	5.6%
		Typical ~ 70%	10	\$94.6	\$102.3	\$7.7	8.1%
		Higher User ~ 10%	20	\$126.2	\$139.3	\$13.1	10.4%
Multifamily Residential	14,850	Typical	4	\$69.4	\$72.8	\$3.4	4.9%
Commercial (incl. Fire Meter Owners)	2,000	Low User ~ 75%	3	\$75.4	\$78.8	\$3.5	4.6%
		Higher User ~ 10%	130	\$536.5	\$632.7	\$96.2	17.9%
8" Fire Meter	~200 of Commercial Accounts			\$587.9	\$595.4	\$7.6	1.3%
Potable Water Irrigation	1,350	Low User ~ 35%	10	\$111.5	\$121.5	\$10.0	8.9%
		Median User ~ 50%	100	\$401.3	\$455.4	\$54.1	13.5%
		Higher User ~ 15%	300	\$1,159.7	\$1,331.6	\$171.9	14.8%
Recycled Water Irrigation	1,200	Low User ~ 15%	10	\$109.4	\$117.3	\$7.9	7.2%
		Median User ~ 65%	100	\$395.7	\$427.0	\$31.3	7.9%
		Higher User ~ 20%	400	\$1,321.8	\$1,434.4	\$112.6	8.5%

Factors Impacting Rate Changes

As shown in the table, higher volume users will experience greater percentage total bill increases. Water commodity rates are increasing approximately 20% and fixed rates by 4% for typical residential customers. The same factors impact commercial and potable water irrigation customers, but to a greater extent. This is due to the following factors:

- Commodity or variable costs include power and chemicals, two cost areas which have increased significantly in the past 2 years.
- While fixed operating costs are also increasing, the District is planning to collect less in current-year revenues for capital projects, which offsets some of these increase needs.
- The 2019 Study methodology incorporated a phasing of 1% property tax revenues to offset fixed charges instead of commodity charges. January 1, 2024 reflects the final year of this shift.
 - Effective with the January 1, 2024 rates, the final \$1 million, or approximately 10% of all 1% property taxes, will offset water fixed rates instead of commodity rates.
 - The shifted 1% property taxes were solely offsetting Tier 1 water rates (for all users). Therefore, the impact of the shift is most greatly felt by higher-use potable water irrigation

and commercial customers. This is because Tier 1 water makes up proportionately more of their usage than for residential customers, who use more Tier 2 and above water.

- As a result, water commodity rates are now more fully reflective of actual costs, and fixed cost increases are mitigated.

Wastewater customer impacts follow similar trends, with higher users experiencing greater percentage increases than lower-use customers. Commodity rates are increasing by 10-13% and fixed rates by 4-5% for commercial customers and decreasing by 1% for residential customers.

- Commodity or variable costs include power and wastewater treatment supplies, including chemicals, all of which have increased significantly in the past 2 years.
- Increases in wastewater fixed costs are primarily related to treatment plant operating costs and staffing which are allocated based on strength of discharge factors, which impacts commercial fixed rates more than residential rates.
- While fixed operating costs are also increasing, the District is planning to collect less in current-year revenues for pay-go capital projects, which offsets other general fixed cost increases.

1.1 RATES

Water Rates

The District’s water rate structure consists of three charges:

- **Fixed Service Charge:** The fixed service charge varies by the size of the meter serving a property and recovers a portion of the District’s fixed costs, including the operational costs, as well as capital project costs and a portion of debt service obligations.
- **Commodity Service Charge:** The commodity service charge is comprised of per unit rates charged for each unit of water delivered. The majority of the District’s customers are on a tiered rate structure, with each tier corresponding to the proportional cost of service when taking into account marginal costs of increased water use.
- **Power Surcharge:** The power surcharge recovers the costs of pumping water to the upper elevation zones. The surcharge is charged per unit of water sold.

Current and Proposed Water Fixed Service Charge

Table 1-5 Monthly Potable and Recycled Water Fixed Charge Rates (\$/Meter Size)

Meter Size	Current	January 1 2024
¾"	\$25.16	\$26.16
1" Residential	\$25.16	\$26.16
1" Commercial	\$33.56	\$35.19
1 ½"	\$54.14	\$57.31
2"	\$79.33	\$84.40
2 ½"	\$109.57	\$116.91
3"	\$147.37	\$157.54
4"	\$222.97	\$238.81
6"	\$432.12	\$463.66
8"	\$684.10	\$734.56

The District implemented a fire meter specific fixed charge, as outlined in the 2019 Study. Table 1-6 below shows the proposed fire meter fixed charges.

Table 1-6 Monthly Fire Meter Fixed Charge Rates (\$/Meter Size)

Meter Size	Current	January 1 2024
1"	\$31.36	\$31.82
1 ½"	\$48.96	\$49.65
2"	\$70.52	\$71.48
2 ½"	\$96.39	\$97.68
3"	\$128.72	\$130.43
4"	\$193.39	\$195.92
6"	\$372.30	\$377.13
8"	\$587.86	\$595.44
10"	\$875.64	\$886.90

Potable Water Commodity Charge Rates

Table 1-7 Potable Water Commodity Charge Rates (\$/CCF)

	Current	January 1 2024
<i>Single-Family and Multi-Family Residential Customers</i>		
Tier 1	\$2.56	\$3.11
Tier 2	\$2.95	\$3.45
Tier 3	\$3.81	\$4.33
Tier 4	\$6.22	\$7.27
<i>Irrigation - Domestic</i>		
Tier 1	\$3.02	\$3.44
Tier 2	\$4.06	\$4.66
Tier 3	\$6.63	\$7.75
<i>Commercial</i>		
Commercial	\$2.62	\$3.22
Construction	\$4.06	\$4.66

Table 1-8 Potable Water Power Surcharge Rates (\$/CCF)

Water Zone	Current	January 1 2024
3	\$0.12	\$0.16
4	\$0.20	\$0.27
5	\$0.34	\$0.45

Recycled Water Commodity Charge Rates

Table 1-9 Recycled Water Commodity Charge Rates (\$/CCF)

	Current	January 1 2024
<i>Recycled - Tiered</i>		
Tier 1	\$2.48	\$2.73
Tier 2	\$3.25	\$3.41
Tier 3	\$5.65	\$4.20
<i>Recycled - Uniform</i>		
Commercial	\$2.53	\$2.80
Construction	\$3.25	\$3.41

Table 1-10 Recycled Power Surcharge Rates (\$/CCF)

Recycled Water Zone	Current	January 1 2024
C	\$0.33	\$0.35
D	\$0.53	\$0.56
E	\$0.69	\$0.74

Wastewater Rates

Like the District's water rate structure, the wastewater rates consist of two charges:

- **Fixed Service Charge:** Fixed charge that recovers the District's fixed operational and maintenance costs that are not related to the quantity of wastewater discharged, as well as for ongoing capital repair and replacement projects.
- **Commodity Charge:** Per unit charges for each unit of wastewater discharged into the wastewater collection system. These charges vary based on customer class and on the assumed wastewater strength characteristics within each class.

Monthly Fixed Service Charge

All wastewater users are charged a common monthly fixed service charge. Multi-family residential customers with an individual meter per dwelling unit are indicated in the table below.

Table 1-11 Single-Family & Multi-Family Residential Wastewater Fixed Charge Rates (\$/Customer Account)

	Current	January 1 2024
Single Family Residential	\$32.21	\$31.96
Multi-Family Residential	\$29.06	\$28.60

Note: For accounts with a separate water meter for a single dwelling unit. Multi-family residential customers with a common meter serving more than a single dwelling unit pay fixed service charges pursuant to Table 1-12.

The rates for multi-family properties with a common meter that serves multiple dwelling- or living-units will be billed a base billing and administrative charge plus a charge per dwelling unit.

Table 1-12 Multi-Family Common Wastewater Fixed Charge Rates

	Current	January 1 2024
Base Monthly Charge	\$14.41	\$13.07
Per Dwelling Unit Charge	\$14.65	\$15.53

The fixed charges for commercial customers account for both the strength of the wastewater that is discharged into the system and the quantity of the typical wastewater discharged.

Table 1-13 Commercial Wastewater Fixed Charge Rates (\$/Customer Account)

Customer Class	Meter Size	Current	January 1 2024
CR	2-inches and smaller	\$30.88	\$30.54
	Larger than 2-inches	\$30.88	\$30.54
C1	2-inches and smaller	\$30.90	\$30.56
	Larger than 2-inches	\$159.11	\$166.52
C2	2-inches and smaller	\$89.20	\$92.38
	Larger than 2-inches	\$160.42	\$167.92
C3	2-inches and smaller	\$91.74	\$95.09
	Larger than 2-inches	\$162.97	\$170.62
C4	2-inches and smaller	\$95.69	\$99.28
	Larger than 2-inches	\$166.92	\$174.81

Wastewater Commodity Charges

In addition to the monthly fixed service charge, the District imposes customer class specific wastewater commodity charges. The commodity charge rates vary by customer class to account for the differences in the strength of the wastewater (loading) discharged into the wastewater collection system.

The proposed wastewater commodity charge rates are summarized in Table 1-15 below.

Table 1-15 Wastewater Commodity Charge Rates (\$/CCF)

Commodity Charge Rates (Wastewater)	Current	January 1 2024
Commercial – C1	\$0.99	\$1.09
Commercial – C2	\$1.22	\$1.35
Commercial – C3	\$1.54	\$1.72
Commercial – C4	\$2.71	\$3.07
Commercial – CR	\$0.59	\$0.62
Residential	\$1.12	\$1.24

Master Metered Communities

Master metered communities are those that have a single or limited number of meters but consist of multiple dwelling units and end-users of water and wastewater services.

Potable Water Fixed Base Monthly Charge

The Fixed Base Monthly Charge consists of two components: 1) Per Account and 2) Capacity Usage Charge.

Potable Water Fixed Base Monthly Charge Components	Current Rate	January 1, 2024
Per Account	\$13.39	\$13.62
Capacity Usage Charge (per ccf)*	\$1.14	\$1.20

*Based on the highest month's usage in the preceding fiscal year.

Monthly Wastewater Fixed Base Charge

The Fixed Base Monthly Charge consists of two components: 1) Per Account and 2) Capacity Usage Charge.

Wastewater Fixed Base Monthly Charge Components	Current Rate	January 1, 2024
Per Account	\$15.65	\$13.30
Capacity Usage Charge (per ccf)*	\$2.38	\$2.65

*Based on the highest month's usage in the preceding fiscal year multiplied by 90%.

2 ANALYSIS INPUTS AND ASSUMPTIONS

Chapter 2 provides an update on the District’s customer accounts, demands, and sources of supply. Overall, the District’s customer account growth is in line with that projected in the 2021 Addendum, as is customer demands for potable and recycled water for FY 2024.

2.1 BASELINE INPUTS

Potable Water System Profile

Table 2-2 Water System Customer Profile

CUSTOMER CLASS	NUMBER OF ACCOUNTS	FY 2024 DEMAND ⁽¹⁾
Single-Family Residential	38,434	14,170
Multi-Family Residential	14,952	2,574
Commercial	971	1,088
Irrigation	1,417	3,943
Fire Service	1,321	6
Total	57,095	21,782

Notes:

- (1) Measured in acre-feet (AF).
- Totals above may not sum due to rounding.

Wastewater System Profile

Table 2-3 Wastewater System Customer Profile

CUSTOMER CLASS	NUMBER OF ACCOUNTS
Commercial – C1	678
Commercial – C2	145
Commercial – C3	17
Commercial – C4	67
Commercial – CR	17
Residential Single-Family	38,368
Residential Multi-Family	14,963

Recycled Water System Profile

Table 2-4 Recycled Water System Customer Profile

CUSTOMER CLASS	NUMBER OF ACCOUNTS	FY 2024 DEMAND ⁽¹⁾
Irrigation	1,543	7,363

Notes:

(1) Measured in acre-feet (AF).

2.2 WATER SUPPLY

Total water demands, as shown in Section 2.2, are assumed to be 21,782 acre-feet (AF) for potable water and 7,363 acre-feet (AF) for recycled water.

The following are summaries of the District’s potable water supplies assumed in Addendum No. 2:

Potable Water Sources	AF*
Baker Water Filtration Plant Water	8,900
MET Treated Water	12,435
City of San Juan Capistrano’s Groundwater Plant (GP)	1,750

*Total supplies exceed demands by 6% to account for “non-revenue” water purchased and produced.

- Baker Water Filtration Plant Water:** The District’s lowest-cost source of potable water is raw water purchased through the Metropolitan Water District of Orange County (MWDOC) and treated at the Baker Water Filtration Plant, operated by Irvine Ranch Water District. The District owns a capacity right in the plant equivalent to 8,900 AF per year and saves approximately \$750,000 per year based on the lower treatment cost compared to MET water.
- MET Treated Water:** The District’s additional treated water supplies are purchased from MET through the MWDOC. These purchases are the District’s largest single source of water cost and are increased or decreased based on changes in demand.
- City of San Juan Capistrano’s Groundwater Plant (GP):** The District completed the acquisition of the City’s water and sewer enterprise fund operations and related customers in November 2021. The City’s water system includes the GP, which produces potable water from local groundwater. Currently, the GP is producing approximately 2,500 AF per year of potable water, 70% (1,750 AF) of which is utilized by the District with the balance of 30% being allocated to existing City of San Juan Capistrano customers.

The following are summaries of the District’s recycled water supplies assumed in the Addendum:

Recycled Water Sources	AF
District Production	4,356
Rancho Mission Viejo Company	1,000
Irvine Water District	1,400
Trabuco Canyon Water District	240
Moulton Niguel Water District	100
Purchase from Other Entities	85

- **District Production:** The District produces recycled water at the Chiquita Water Reclamation Plant currently. This is the District's lowest cost source of recycled water. The Oso Creek Water Reclamation Plant is offline for FY 2024 and had previously provided approximately 1,350 to 1,600 AF of recycled water. It is expected to come back online in FY 2025 with additional recycled water production capacity.
- **Rancho Mission Viejo Company:** The District is obligated through agreement to purchase certain riparian water available from lands owned by the Rancho Mission Viejo Company. The amount of water available gradually increases based on development in Improvement District 5, which is currently being developed as the Village of Rienda.
- **Other Agency Purchases:** Because the Oso Creek Water Reclamation Plant is offline for FY 2024, the District has budgeted and anticipates supplemental purchases from neighboring agencies.

3 REVENUE REQUIREMENT ANALYSIS

Addendum No. 2 updates the revenue requirement analysis section, which establishes the basis and necessity for the January 1, 2024 rate increase. The analysis utilizes the updated financial information contained in Chapter 1 of this Addendum. This analysis also incorporates current unrestricted cash and investment balances and anticipated capital improvement plan expenditures.

Once the revenue requirement is established by compiling the District’s cost drivers, the following three tests are utilized to refine the rate revenue requirements:

- (1) Cash Flow Sufficiency Test
- (2) Debt Coverage Ratio Test
- (3) Available Cash Reserve Test

As presented in this section, without the January 1, 2024 rate increase contemplated, the District would face the following financial deficiencies:

- The District’s water and wastewater service revenues would not be sufficient to meet pay-as-you-go capital project needs in FY 2024.
- The District’s debt service coverage ratio would fall below its policy minimum established in its Reserve and Fiscal Policies in FY 2024.
- As a result of the deficiencies above, the District would otherwise be required to spend down its cash reserves for these unmet needs, ultimately ending up with reserves substantially below its Reserve and Fiscal Policies goal requirement.

With the contemplated 9% rate increase, this Chapter documents the District will generate sufficient revenues to meet its capital funding plan for FY 2024 and have sufficient debt service coverage and ending unrestricted reserve levels to comply with its Reserve and Fiscal Policies Goals.

3.1 CASH FLOW SUFFICIENCY TEST

The cash flow sufficiency test evaluates the District’s ability to meet operating and capital expenditures. When projected revenues are insufficient to meet operating and capital costs on a cash flow basis, rate revenues are adjusted accordingly. The cash flow test is conducted separately for the District’s water service (potable and recycled water) and wastewater service.

Potable Water and Recycled Water System

The table below indicates the District’s financial position in its water system (both potable and recycled) without any rate increase on January 1, 2024.

Table 3-1 Actual and Projected Potable Water and Recycled Water System Operating Revenues and Expenses Prior To Rate Adjustments (\$1,000)

ADDENDUM UPDATED	
REVENUE CATEGORY	FY 2024
Rate Revenue ⁽¹⁾	\$62,270
Joint Operating Facilities Revenue	\$860
Misc. Operating	\$2,192
Misc. Non-Operating	\$2,547
Share of 1% Prop. Tax Revenues	\$4,914
Connection Fees	\$903
Total Revenues	\$73,687
EXPENSE CATEGORY	FY 2024
Water Purchases	\$31,133
Regional Facilities	\$774
Power	\$5,396
Salaries & Benefits	\$15,210
Operations and Maintenance	\$7,498
Wastewater Treatment	\$0
General & Admin	\$5,322
Total Operating Expenditures	\$65,331
Debt Service	\$7,013
Total Non-Capital Expenditures	\$72,344
Purchased Assets	\$1,534
Capital Project Funding ⁽²⁾	\$2,549
Total Funding Needs	\$76,428
Net Revenues/(Shortfall)	(\$2,740)

Notes:

- (1) Assumes 0% or no rate increase on January 1, 2024.
- (2) Capital Project Funding indicated is the portion required for pay-as-you-go funding.
 - Totals above may not sum due to rounding.

As indicated above, the District will not generate sufficient revenues to pay a portion of its annual capital improvement program without any rate increases. Further, as will be shown in the Cash Reserves test section, without the additional rate revenues, the District would need to draw on reserves to meet its capital needs and would not meet its reserve policy goals.

As depicted in Table 3-2 below, however, with the 9% rate increase on January 1, 2024, the District will generate sufficient revenues to meet all its funding needs for FY 2024.

Projected Revenues with Rate Increase

Table 3-2 Potable Water and Recycled Water System Operating Revenue Requirements (\$1,000)

ADDENDUM UPDATED	
REVENUE CATEGORY	FY 2024
Rate Revenue (Base)	\$62,270
Other Revenues	\$11,417
Percent Rate Increase (From Prior Year)	9.00%
Additional Rate Revenues	\$2,740
Total Revenues	\$76,428
Total Funding Needs	\$76,428
Net Revenues/(Shortfall)	\$0

Notes:

- Totals above may not sum due to rounding.
- Total Funding Needs are defined in the prior Table 3-1.

Wastewater System

The table below indicates the District's financial position in its wastewater system without any rate increase on January 1, 2024.

Table 3-3 Projected Wastewater System Revenues and Expenditures Prior To Rate Adjustments (\$1,000)

ADDENDUM UPDATED	
REVENUE CATEGORY	FY 2024 BUDGET
Rate Revenue ⁽¹⁾	\$26,687
Joint Operating Facilities Revenue	\$512
Misc. Operating	\$430
Misc. Non-Operating	\$2,253
Share of 1% Prop. Tax Revenues	\$5,382
Connection Fees	\$989
Total Revenues	\$36,253
EXPENSE CATEGORY	FY 2024 BUDGET
Water Purchases	\$0
Regional Facilities	\$18
Power	\$2,451
Salaries & Benefits	\$12,446
Operations and Maintenance	\$5,772
Wastewater Treatment	\$4,294
General & Admin	\$3,357
Total Operating Expenditures	\$28,336
Debt Service	\$1,744
Total Non-Capital Expenditures	\$30,081
Purchased Assets	\$666
Capital Project Funding ⁽²⁾	\$6,681
Total Funding Needs	\$37,427
Net Revenues / (Shortfall)	(\$1,175)

Notes:

- (1) Assumes 0% or no rate increase on January 1, 2024.
- (2) Capital Project Funding indicated is the portion required for pay-as-you-go funding.
 - Totals above may not sum due to rounding.

As indicated above, the District will not generate sufficient revenues to pay a portion of its annual capital improvement program without any rate increases. Further, as will be shown in the Cash Reserves test section, without the additional rate revenues, the District would need to draw on reserves to meet its capital needs and would not meet its reserve policy goals.

As depicted in Table 3-4 below, however, with the 9% rate increase on January 1, 2024, the District will generate sufficient revenues to meet all its funding needs for FY 2024.

Projected Revenues With Rate Increase

Table 3-4 Projected Wastewater System Revenue Requirements (\$1,000)

REVENUE CATEGORY	ADDENDUM UPDATED
	FY 2024 BUDGET
Rate Revenue	\$26,687
Other Revenues	\$9,566
Percent Rate Increase (From Prior Year)	9.00%
Additional Rate Revenues	\$1,175
Total Revenues	\$37,427
Total Funding Needs	\$37,427
Net Revenues/(Shortfall)	\$0

Notes:

- Totals above may not sum due to rounding.
- Total Funding Needs are defined in Table 3-3.

3.2 DEBT SERVICE COVERAGE AND AVAILABLE CASH

Debt Coverage Ratio Test

The second test is the debt service coverage ratio test. The debt service coverage ratio is calculated by dividing net cash flow (net revenues) by the required debt service amount.

The District anticipates issuing an additional \$75 million in revenue bond debt in the current year. To ensure favorable credit ratings and the resulting low interest rate on its debt, the District adopted a policy goal, under its Reserve and Fiscal Policies, of maintaining a debt service coverage ratio of at least 1.50x, or 50 percent of annual debt service. The revenue requirement analysis therefore includes a 1.50x debt service coverage ratio test.

The debt coverage test is assessed on the District’s service lines on a combined basis. This is because all the rate revenues are pledged for the purpose of debt repayment and are the basis of the District’s 1.50x debt service coverage policy. The District’s current debt obligations are secured by a pledge of net “System Revenues” which are defined as potable water, recycled water, and wastewater revenues.

Table 3-6 Projected Debt Service Coverage Prior To Rate Adjustments (\$1,000)

ADDENDUM UPDATED	
CATEGORY	FY 2024
Total District Revenues ⁽¹⁾	\$109,940
Total District Operating Expenditures	\$93,667
Total District Net Revenues	\$16,273
Existing District Debt Service ⁽²⁾	\$7,237
Projected New Debt Service ⁽³⁾	\$4,374
Debt Service Coverage Ratio ⁽⁴⁾	1.40x

Notes:

- (1) Includes all revenues prior to rate adjustments from Table 3-1 (potable and recycled water) and Table 3-3 (wastewater).
- (2) Based on existing FY 2024 debt service payments secured by pledge of District net revenues (2020A Revenue Bonds and SRF Loan).
- (3) Projected debt service on \$75 million of revenue bonds expected to be issued by end of FY 2024.
- (4) Net Revenues divided by Existing plus Projected New Debt Service.

While the projected debt service costs will not commence until the following fiscal year, the District requires the revenues and related coverage prior to issuing the Bonds to meet its debt service policy. The District's debt service coverage ratios will decrease significantly without any rate revenue increases. Debt coverage would be only 1.40x in FY 2024, which is below the District's 1.50x policy minimum. With the rate increases indicated, however, the District is projected to exceed its target, as shown in the table below.

Table 3-7 Projected Debt Service Coverage After Rate Adjustments (\$1,000)

ADDENDUM UPDATED	
CATEGORY	FY 2024
Total District Revenues ⁽¹⁾	\$113,855
Total District Operating Expenditures	\$93,667
Total District Net Revenues	\$20,188
Existing District Debt Service	\$7,237
Projected New Debt Service ⁽³⁾	\$4,374
Debt Service Coverage Ratio ⁽⁴⁾	1.74x

Notes:

- (1) Includes all revenues from Table 3-6, plus revenues from 9% rate increase.

Unrestricted Cash Reserves Test

The third test is the available cash reserves test. The District’s adopted Reserve and Fiscal Policies are part of the District’s comprehensive financial strategy to ensure conservative and prudent fiscal practices. The policies call for the District to maintain financial reserves to ensure the District provides a high level of emergency preparedness for its customers and well-maintained infrastructure for current and future customers. To accomplish these goals, the District’s Reserve Policy establishes certain reserve funding level minimums and goals. This includes a Fiscal Policy goal of maintaining reserves at least equal to a full year of operating costs, or 270 “days” of reserves.

As indicated in the tables below, absent any rate increases, the District would not meet this fiscal policy, and would experience a shortfall of \$3.4 million in FY 2024. Under the rate increases assumed, the District is projected to meet its Policy goals slight surplus of approximately two “days” of operating expenses.

Table 3-8 Projected Cash Reserves Prior To Rate Adjustments (\$1,000)

	ADDENDUM UPDATED
AMOUNTS	FY 2024
Minimum Reserves Required ⁽¹⁾	\$69,288
Projected Reserves Available	\$65,900
Surplus/(Shortfall)	(\$3,389)

Notes:

- (1) Equal to total District expenses in each such year, or “270 days” of operating expenses.
 - Totals above may not sum due to rounding.

Table 3-9 Projected Cash Reserves After Rate Adjustments (\$1,000)

	ADDENDUM UPDATED
AMOUNTS	FY 2024
Minimum Reserves Required ⁽¹⁾	\$69,288
Projected Reserves Available	\$69,815
Surplus/(Shortfall) ⁽²⁾	\$526

Notes:

- (1) Equal to total District expenses in each such year, or “270 days” of operating expenses.
- (2) Projected amount equates to approximately 2 “days” of operating expenses, or 0.75% of Minimum Reserves Required.
 - Totals above may not sum due to rounding.

4 LIST OF APPENDICES

APPENDIX A – GENERAL ASSUMPTIONS, OPERATION AND MAINTENANCE (O&M) COSTS, REVENUES, CAPITAL COSTS, FUNDING

Note: Appendices will be included in version in October 20 Board Package

Appendix A includes detailed calculations for the subsequent items:

- *Assumptions (Escalation Factors)*
- *Service Line Allocation*
- *Revenue Requirement*
- *Capital Funding Summary*
- *Capital Projects*
- *Debt*
- *Water Purchases*

APPENDIX B – POTABLE AND RECYCLED WATER CUSTOMER AND DEMAND FORECAST, FUNCTIONAL AND CUSTOMER ALLOCATIONS

Note: Appendices will be included in version in October 20 Board Package

Appendix B includes detailed calculations for the subsequent items:

- *Customer Forecast – Potable and Recycled Water*
- *Customer Data*
- *Functional Allocation – Potable Water*
- *Customer Allocation – Potable Water*
- *Function Allocation – Recycled Water*
- *Customer Allocation – Recycled Water*

APPENDIX C — POTABLE AND RECYCLED WATER FIXED AND COMMODITY CHARGES AND POWER SURCHARGE

Note: Appendices will be included in version in October 20 Board Package

Appendix C includes detailed calculations for the subsequent items:

- *Water and Recycled Water Fixed Charges*
- *Water Commodity Rate Design*
- *Recycled Water Commodity Rate Design*
- *Power Surcharge Rate Design*

APPENDIX D – WASTEWATER SYSTEM FORECAST, FUNCTIONAL AND CUSTOMER ALLOCATIONS, FIXED AND COMMODITY CHARGES

Note: Appendices will be included in version in October 20 Board Package

Appendix includes detailed calculations for the subsequent items:

- *Wastewater Customer Forecast*
- *Wastewater Customer Data*
- *Functional Allocation – Wastewater*
- *Customer Allocation – Wastewater*
- *Wastewater Rates*
- *Master Metered Community Rates*