

# Memorandum

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Date: July 6, 2011

From: Jason Mumm

To: Mitch Chambers, Stonegate Village Metropolitan District

CC: Jim Nikkel, Parker Water & Sanitation District

Re: StepWise Inclusion Analysis Compared to 2010 PWSD Rate Study

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In the presentation of our findings related to the proposed inclusion of Stonegate Village Metropolitan District (Stonegate)<sup>1</sup> with the Parker Water & Sanitation District (PWSD), we have compared what we termed a “Stand-Alone” financial projection with the proposed financial projection under inclusion, called a “Consolidated” plan.

In 2010, PWSD completed a rate study performed by another firm as part of its public process related to adjusting the rates for water and sewer service. The report, completed by Red Oak Consulting (Red Oak Report) was posted on the PWSD web site and has been available to the public since 2010. As we began our analysis of the PWSD “Stand-Alone” scenario, we of course started with the 2010 report. In working collaboratively with PWSD management, however, it was noted that the 2010 report was in need of various revisions. The Red Oak Report contained recommendations for 2009 through 2018 even though the final report was not published until 2010.

Under PWSD management’s direction and approval, we made a number of updates to the 2010 report. The net result of those updates is that our inclusion analysis of the “Stand-Alone” projection for PWSD contains a different set of findings than those presented in the 2010 report. This memorandum describes the major findings from the 2010 report, the changes made during our inclusion analysis, and compares the results of both.

The information contained in this memorandum has been previously provided to the PWSD Board of Directors.

## Major Findings of 2010 Red Oak Study

The Red Oak Study resulted in a series of proposed rate increases starting with immediate increases of 27% and 21% for water and sewer services, respectively. Those increases would have gone into effect, had the report’s recommendations been followed, in 2009. Subsequent years of increases were also proposed between 10% and 17% for water service, and around 4% for sewer service. The increases were proposed through at least 2018, the final year in the long-range plan prepared for the report. The large and continuing increases in rates were proposed in large part to fund a substantial cash reserve that reached nearly \$100 million by 2018.

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<sup>1</sup> Stonegate’s water and sewer utility services include by intergovernmental agreement services to the Lincoln Park Metropolitan District, the Compark Business Campus Metropolitan District; and the E-470/Potomac Metro District.

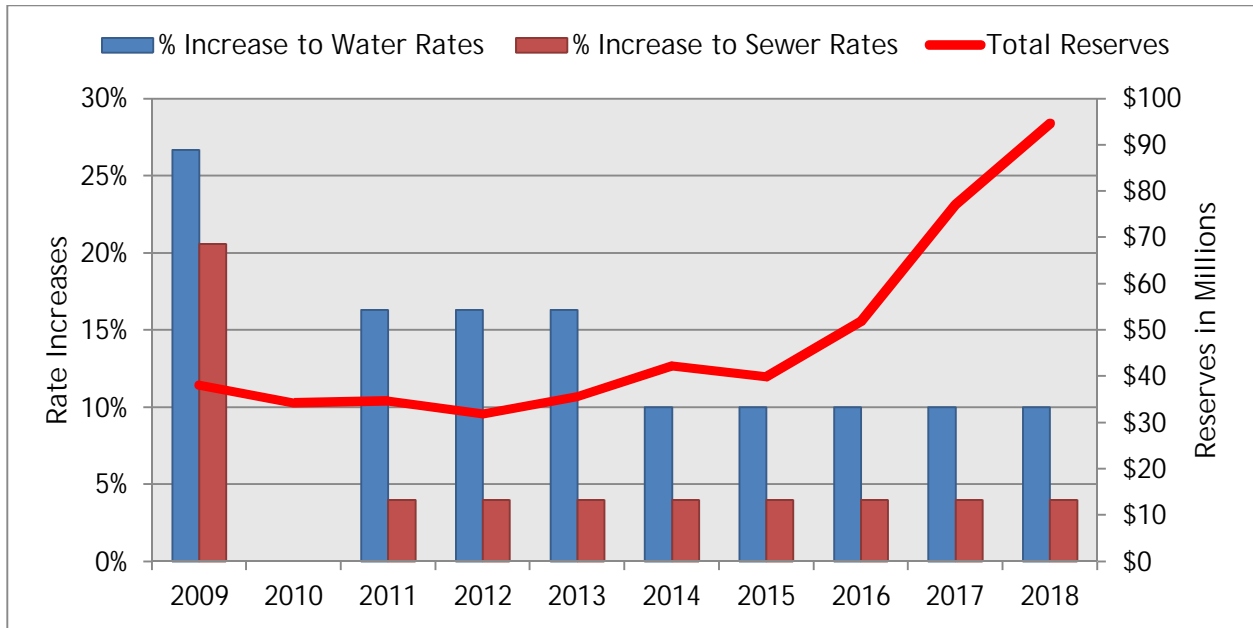


Figure 1: Major Findings of Red Oak Study (2010)

### Departures from Red Oak Report Findings

The PWSD Board of Directors did not implement the findings from the Red Oak Report. With respect to water service, the report recommends a 27% increase in 2009 and a 16.3% increase in 2011. The PWSD Board actually adopted only a 14% increase in 2010 with no increase in 2009 or 2011. With respect to sewer services, the report recommends a 20.6% increase in 2009 and a 4% increase in 2011; the PWSD Board actually adopted a 28% increase in 2010, but no increase in 2009 or 2011.

Apart from the variance between the Red Oak Report findings and the actual actions taken by the PWSD Board, there were additional issues with the analysis in the Red Oak Report that required adjustment. There were several differences attributable to availability of actual information that was available to us, but would not have been available to Red Oak at the time of their report; other changes were necessary in order to keep assumptions common to all of our analyses for the inclusion (e.g. inflation). The following is a summarized list:

Table 1: Summary List of Differences Between Red Oak Report and StepWise Inclusion Analysis

Study Component/Feature Changed by StepWise	StepWise Study	Red Oak Report
Debt Service	30 year term at 4.0%, increase in amount of debt issued.	25 year term at 5.0%.
Asset Replacements	2.5% of total assets starting in 2015; annual spending is between \$10 and \$15m per year for water and between \$1 and \$3m for sewer through 2030	No asset replacement costs were accounted for in the study.
Operations and Maintenance Cost Projections	Based on actual 2010 expenses (pre-audit)	Based on 2009 budget, approximately \$4.4 million over actual for water and \$1.0 million over for sewer in 2010
Inflation Rate	2.5%, consistent with Federal Reserve Bank's projections.	4.0%
Rueter Hess Reservoir Project Costs	\$42.2m in 2009 (actual posted value used) + additional \$40m in 2010 and 2011	None of these project costs were accounted for in the study.
Reserves Levels at 2018 (end of RO Plan)	\$59.2 million total \$0 million "surplus"	\$94.7 million total \$35.9 million "surplus" funds
Beginning Reserve Levels at 2011	\$88.75 million based on audit results for 2010	\$34.7 million projected from 2009.
Rate-Funded CIP	\$1m in water rights acquisitions + \$600k in equipment and other capital acquisitions; total \$1.6m per year	\$1m in water rights acquisitions only.
West Interceptor Phase II	Project was removed (determined unnecessary by management)	\$8.0 million project was included.

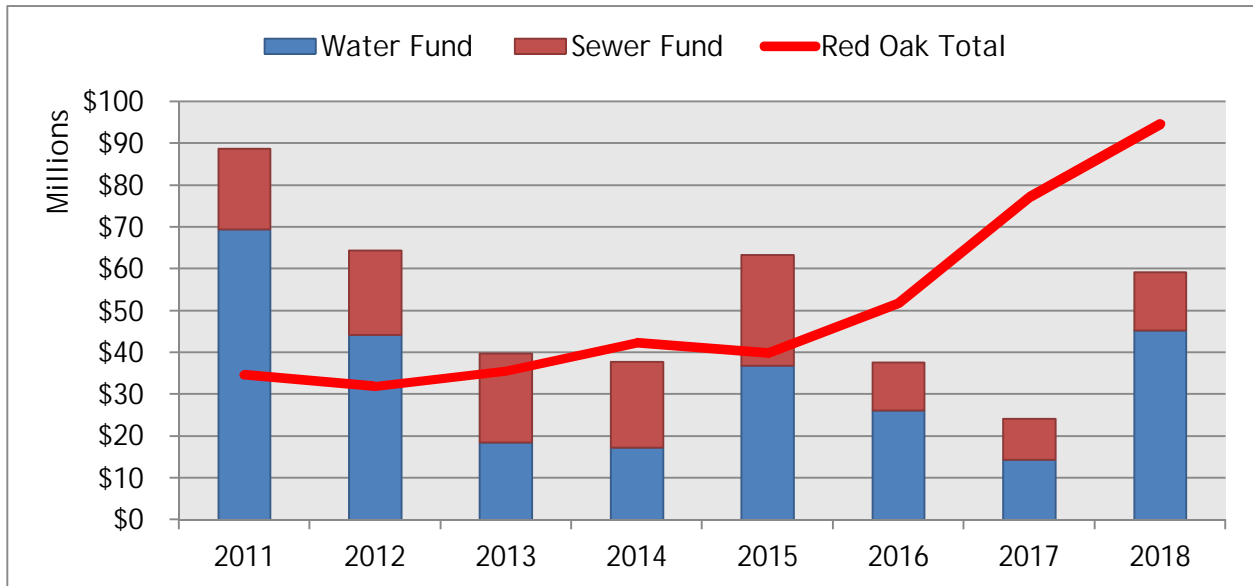
## Comparison of StepWise Findings and Red Oak Report

The study prepared by StepWise for the inclusion analysis contains a longer plan horizon than did the Red Oak Report. Our findings for every year beyond 2018 cannot be compared to the Red Oak Report simply due to the difference in plan length. However, the above departures did have a material impact on the findings between now and 2018, and those differences can be easily compared and contrasted.

### Difference in Projected Fund Balances

The sum total of the changes in inputs and assumptions described above resulted in a reduction in the proposed total fund balance, otherwise known as the reserve level. The Red Oak Report proposed a near \$100 million reserve level by 2018<sup>2</sup>; our revisions resulted in a decrease in overall reserve level to approximately \$60 million in the same time.

Table 2: Comparison of Red Oak Report Proposed Reserve Level to StepWise Analysis



### Difference in Proposed Rate Increases

Both of the “Stand-Alone” plans that we developed for PWSD – one for water and one for sewer – showed a decrease in the proposed rates as compared to the Red Oak Report.

<sup>2</sup> The primary reason for the \$100 million reserve in the Red Oak Report was that while the report recommended continued rate increases between 2015 and 2018, there was virtually no projected CIP spending in that same period. PWSD management advised that typical capital spending at approximately 2.5% of total assets is an appropriate planning level; StepWise used management’s estimate for the inclusion study.

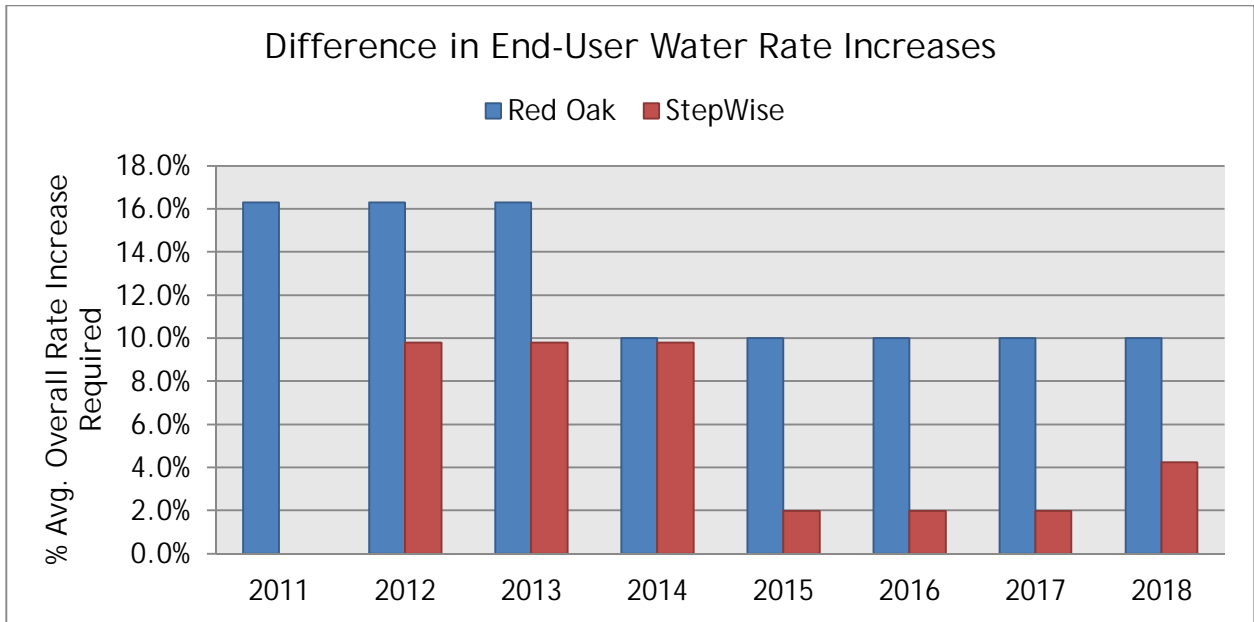


Figure 2: Comparison of Average Increases in User Charges for Water Service<sup>3</sup>

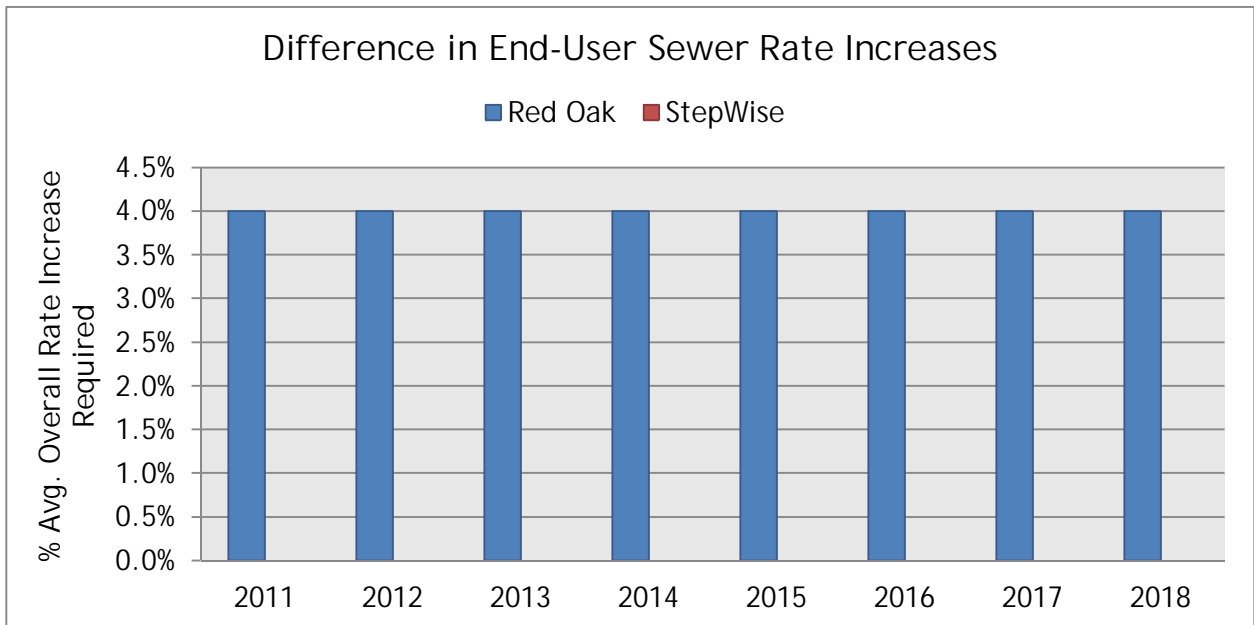


Figure 3: Comparison of Average Increases in User Charges for Wastewater Service<sup>4</sup>

<sup>3</sup> An increase of 14% was approved by the PWSD Board in 2010 (not shown in the chart)

<sup>4</sup> An increase of 28% was approved by the PWSD Board in 2010 (not shown in the chart)