



October 9, 2014

Mr. Michael Ott
Executive Director
San Diego County Local Agency Formation Commission
9335 Hazard Way, Suite 200
San Diego, CA 92123

Subject: RMWD/FPUD Water Rate Comparison

Dear Mike:

Thank you for the opportunity to review and comment on the water rate analysis that was performed by Michael Bell Management Consulting (MBMC) for the Fallbrook Public Utility District (FPUD). We appreciate the opportunity to explain the concept of water rates as they are applied here at Rainbow and at FPUD.

As you are no doubt aware, water rates have many components and even the term "rates" is misconstrued by customers and others. The interplay between fixed charges and variable charges alters how a water bill changes as consumption patterns change. Higher consumption tends to dilute the impact of fixed charges on water bills; for low consumption customers the fixed charges can be a majority of the bill. There are also certain characteristics of different water districts that affect the water rate structure.

For instance, RMWD has over 300 miles of pipelines and fewer than 8000 service connections. As a primarily rural agency, this gives RMWD one of the lowest service connection densities of any agency in San Diego County. This also means that we maintain more infrastructure per service connection which in turn leads to higher fixed costs.

Another factor is the characteristics of the customer base. Whereas one might think that FPUD and RMWD are very similar, the reality is that we have very different types of customers. In the RMWD service area we have much larger lots (Mean size= 4.49 Acres, Median =1.96 Acres) while at FPUD they do have some large parcels but most of the district is comprised of subdivision style parcels (Mean size = 2.51 acres, Median = 0.57 Acres).

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Of these two values the median value is most illustrative, in that it represents the mid-point of the population of parcels in each District. The data reveal that the median parcel in RMWD is nearly 4 times the size of the median parcel in FPUD. When combined with the fact that the average parcel is nearly twice the size as well, it shows that FPUDs customers have much smaller lots than Rainbow and thereby will use less water on average on these lots. Rainbow's rates are structured around large lots with high water use customers. Our average water consumption per account is over 100 units of water per month.

In my review of the MBMC report it is clear that the conclusions drawn by the report are incomplete at best, and misleading at worst. The consultant has chosen a narrow range of demand patterns that seem to have been selected to show the intended result – that FPUD has lower "rates". As I indicated earlier, the same water rate can mean different things to different customers based on their consumption patterns.

I also attempted to reconstruct the calculations in the various Exhibits in the report and I believe that there is a miscalculation in each table. The FPUD rate table includes a "Capital Improvement Charge" of \$8.59 per Equivalent Meter Unit (EMU) and this varies by meter size. For instance, a 1" meter has an allotment of 1.375 EMUs and a 2" meter has 3.125 EMUs. If my calculations are correct, the MBMC report failed to use this multiplier and underreported the total bills. For a 2" meter the monthly bill was underreported by \$18.25 per month. This error has skewed the data in the favor of FPUD.

If you review the tables given in Exhibits 1 and 2 of the MBMC report, you will quickly notice that the demand pattern starts at 5 units of water and ends at 60 units. While this may be a normal range of demands for small FPUD parcels, remember that the average consumption at Rainbow is over 100 units. When you review these tables you will see the "advantage" enjoyed by FPUD customers at lower rates quickly disappear and turn into a negative savings at 60 units. Coincidentally, that is where the comparison stopped. At higher consumption levels the advantage goes to RMWD in increasing amounts.

I have included a graph that correctly represents the impact of the two rate structures as Attachment 1. This shows that the impact of our higher fixed costs turns net positive for RMWD customers at about the 45000 gallon per month point. This same sort of situation is repeated for other meter sizes and customer classes, as indicated in the MBMC report.

Which agency has lower “rates” here? The real answer is neither, as the rates are structured to meet the average consumption patterns of the customers that each agency serves. If Rainbow used FPUD’s rates the bills of our average consumption users would be much higher than they are now. Conversely, if FPUD used Rainbow’s rate structure the bills for their average consumption user would be higher. To be sure, in each agency there are customers who may do better using one rate or the other, but each Board must select rates to serve the majority of the customers best – it would be impractical to devise a rate that fit every single possible consumption pattern.

In addition, the table in Exhibit 3 makes an incorrect comparison of rates. It appears that the consultant has compared Rainbow’s Agricultural Domestic Rate to FPUD’s Commercial Agricultural rate rather than comparing each agency’s commercial agricultural rates. Rainbow’s commercial ag rate is \$2.83 for 748 gallons (\$0.003783 per gallon) and FPUD’s is \$4.06 for 1000 gallons (\$0.00406 per gallon). As indicated earlier, Rainbow has higher fixed charges based on our infrastructure so the bill is higher for RMWD until the user gets to about 125 units per month where it becomes slightly lower than FPUD. Attachment 2 highlights the correct comparison between the Commercial Ag rate for each agency.

The reality of water rates is that they have very little meaning without the context of the consumption patterns of those customers who are subject to the rates. The water bill is different for different classes of customers within the same agency and will be different for the same classes of customers in neighboring agencies. It all depends on the factors at play within each specific agency and the Boards of each agency strive to fit the rate structure that matches their constituents the best. This is the case here between FPUD and RMWD.

In addition, the entire discussion of water rates is not germane to the decision at hand at LAFCO because FPUD’s proposal will include an accounting system that keeps the two systems separate as far as rates are concerned. Indeed, Mr. Brady has stated on multiple occasions that the proposed dissolution/annexation would not affect rates because of the divisional accounting system. The fundamentals that drive the rate structures in both agencies will not change in a material way as a part of this proposed process so it is unlikely that the proposed successor agency will make any dramatic alterations in rates.

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I know that a number of Rainbow customers have indicated in their letters of opposition that they enjoy RMWD's lower rates. I also know that FPUD has gathered email addresses and home addresses from each of these ratepayers and has sent them unwanted and misleading materials in an effort to dissuade them from supporting Rainbow. The reality is that while some of the customers in each District may not fully understand the rate structures, if one were to apply FPUD's rate structure to our average user they would see higher bills, so this line of objection is perfectly valid.

I appreciate the opportunity to comment on the FPUD rate study and am happy to answer any questions you may have on the matter.

Sincerely,

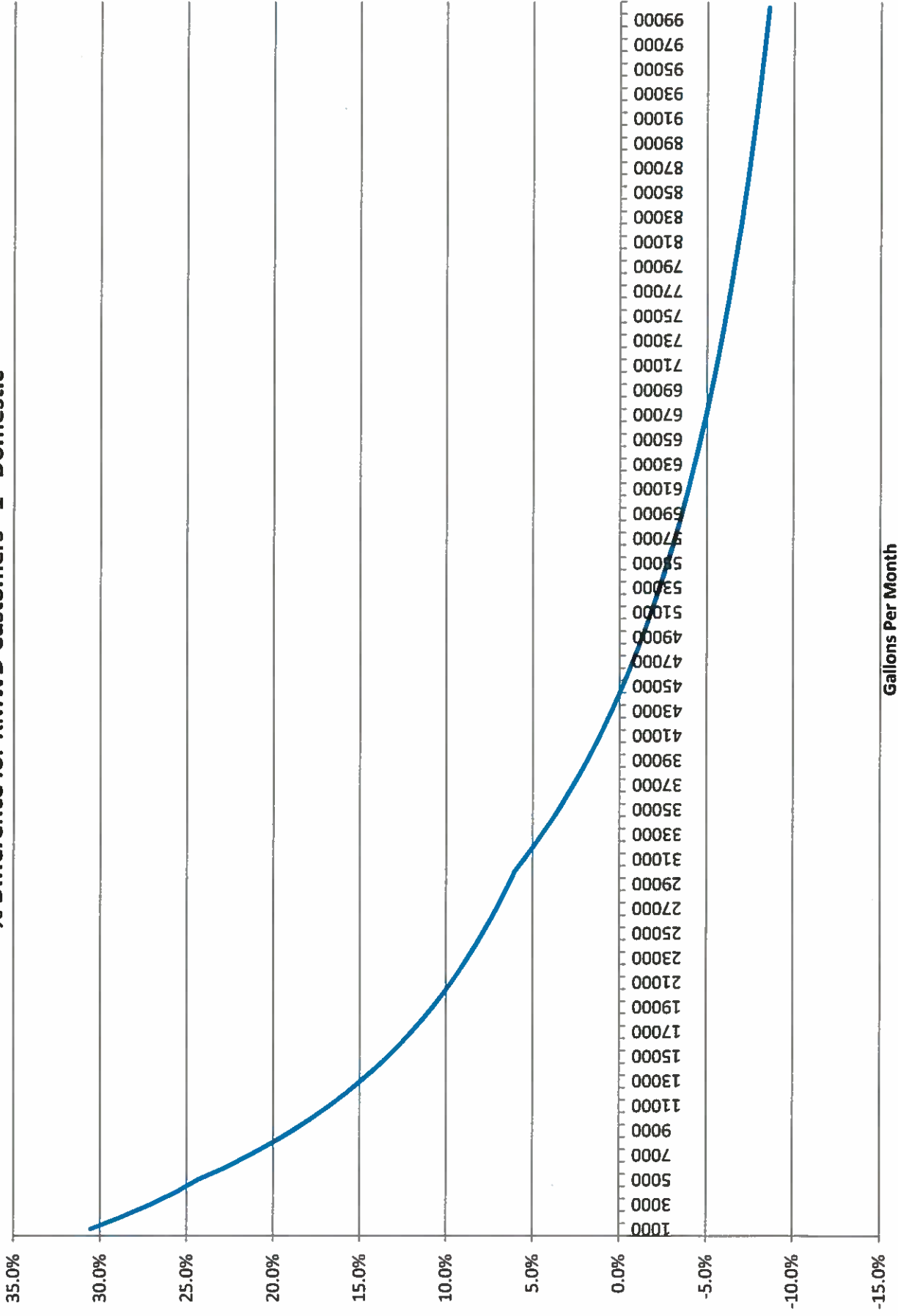
RAINBOW MUNICIPAL WATER DISTRICT

A handwritten signature in black ink, appearing to read "Tom Kennedy", is written over the typed name and title. The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Tom Kennedy
General Manager

cc: Board of Directors
General Counsel

**Attachment 1:
% Difference for RMWD Customers - 1" Domestic**



Gallons Per Month

Attachment 2: % Difference for RMWD Customers - 2" SAWR Commercial

