

E-mail

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Hello Glenn,

Thank you for providing the documents I requested and allowing me to provide input on the proposed 2019 Capital Facility Fees (Cap Fees). Please pass along my concerns to the Board as I plan on providing public comment at the rate hearing and referring to this e-mail and attachments.

Four concerns from a ratepayer perspective are 1) the revenue shortfall caused by a four-year delay in implementing new Cap Fees; 2) the lack of timeliness in recovering the deficit; 3) Vallecitos' expressed intent to continue to finance developer obligations with ratepayer money; and 4) the lack of transparency and integrity in the rate process.

The revenue shortfall from the four-year delay in implementing sufficient Cap Fees may not be an issue if Vallecitos corrects the assumption for the number of EDUs used in the calculations. Because of the delay, the timeline for analysis and rate calculation was appropriately adjusted in the rate model to July 1, 2018 through 2035 (originally started with 2014). All expenditures required of developers are for a seventeen-year period, and should be divided by seventeen years of EDU additions to calculate the correct Cap Fee to cover developer obligations. The model had input and comments intending to change the EDUs from the original twenty-year period to match the seventeen-year period. However, an apparent formula error resulted in maintaining twenty years of EDU additions. The attached letter provides details.

The developer fund deficit resulted from policy decisions 1) allowing a particular developer to build free of the Sewer Density Impact Fee, 2) deferring the time to pay Cap Fees, 3) suspending and refunding of the Sewer Density Impact Fee, 4) delaying implementation of adequate Cap Fees, and 5) cash financing developer obligations with ratepayer money. Because there is not money in the developer fund (negative balance), ratepayers have been paying developer obligations. If all the assumptions in the rate model are correct, ratepayers will be paid back in 2035. Ratepayers should not have to wait to 2035 to be paid back for something that they shouldn't have paid for in the first place. The deficit needs to be carved out and recovered in five years – before the next Cap Fee study.

Vallecitos has accumulated more ratepayer money than any other agency in San Diego County - \$94 million as of April 30, 2019. Setting rates to accumulate money sufficient to maintain reserves as well as pay developer obligations is not in the best interest of the ratepayer. Using ratepayer money to pay developer obligations is not a benefit to the ratepayer. Paying developer obligations is not a cost of service. Issue debt to pay developer obligations as assumed in the Cap Fee rate model instead of using ratepayer money. Vallecitos has plenty of debt capacity.

The people's business is to be conducted openly. Proposed Cap Fees were downwardly adjusted in a private meeting with developers. Ratepayers, unwilling creditors, are stakeholders, but were excluded from the proceedings of private meetings. The sole objective of Cap Fees should be to recover developer impacts from developers, not "to be competitive." Since 2013, ratepayers have been unnecessarily burdened with paying ratepayer obligations to keep Cap Fees low, and will continue to unless the preceding concerns are adequately addressed at the Public Hearing for Cap Fees.

If you have any questions or care to discuss further, please correspond by e-mail.

Thank you,  
tom

May 28, 2019

Glenn Pruim, General Manager  
 Vallecitos Water District  
 201 Vallecitos de Oro  
 San Marcos, CA 92069

Re: Proposed Capital Facility Fees

Dear Mr. Pruim:

Thank you for allowing me to provide input regarding Vallecitos Water District’s proposed 2019 Capital Facility Fees (Cap Fees). Please pass along my concerns to the Board as I plan on providing public comment at the rate hearing and referring to this letter and attachments.

Four concerns from a ratepayer perspective are 1) the revenue shortfall caused by a four-year delay in implementing new Cap Fees; 2) the lack of timeliness in recovering the deficit; 3) Vallecitos’ expressed intent to continue to finance developer obligations with ratepayer money; and 4) the lack of transparency and integrity in the rate process.

Revenue Shortfall

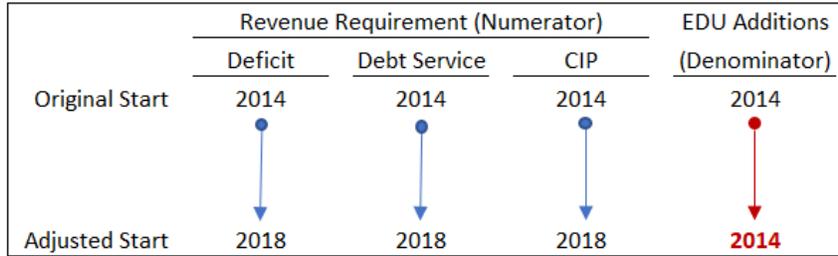
When the Board suspended the Sewer Density Impact Fee in 2015 they minimalized the negative fiscal impacts by expressing their intention of adopting the Master Plan (MP) that same year with the new Cap Fee to immediately follow. The new Cap Fee would include recovery of additional sewer treatment capacity. Four years later we still don’t have Cap Fees sufficient to pay developer obligations. The revenue that Vallecitos could of realized by timely and appropriately adjusted rates, compared to actual revenues accounts for a significant revenue shortfall and attributed to the escalating deficit.

The rate model seems to have attempted to address a portion of the revenue shortfall by adjusting the start of the timeline of the revenue requirement from 2014, the original Master Plan (MP) start date, to 2018. The adjusted revenue requirement for the Water Cap Fee is made up of the developer fund deficit as of June 30, 2018; existing debt service starting from July 1, 2018; and payment for growth-related Capital Improvement Projects (CIP) starting in 2019.

Excerpt from Vallecitos Rate Model for the Water Cap Fee Calculation

|    | A  | B    | C            | D             | G        | J            | M           |
|----|----|------|--------------|---------------|----------|--------------|-------------|
| 10 |    |      |              | Existing Debt | Phase 1  | Phase 2      | Phase 3     |
| 11 |    | CY   | Deficit      | Service       | Payment  | Payment      | Payment     |
| 12 | -  | 2018 | \$ 9,161,412 | \$ 1,544,459  |          |              |             |
| 13 | 1  | 2019 |              | 2,137,155     | 134,581  |              |             |
| 14 | 2  | 2020 |              | 2,139,195     | 269,162  |              |             |
| 15 | 3  | 2021 |              | 2,141,108     | 269,162  |              |             |
| 16 | 4  | 2022 |              | 2,140,215     | 269,162  |              |             |
| 17 | 5  | 2023 |              | 2,141,618     | 269,162  | \$ 1,150,247 |             |
| 18 | 6  | 2024 |              | 2,142,510     | 269,162  | 1,150,247    |             |
| 19 | 7  | 2025 |              | 2,142,765     | 269,162  | 1,150,247    |             |
| 20 | 8  | 2026 |              | 2,147,355     | 269,162  | 1,150,247    |             |
| 21 | 9  | 2027 |              | 2,148,248     | 269,162  | 1,150,247    |             |
| 22 | 10 | 2028 |              | 2,147,993     | 269,162  | 1,150,247    | \$ 592,183  |
| 23 | 11 | 2029 |              | 2,151,563     | 269,162  | 1,150,247    | 592,183     |
| 24 | 12 | 2030 |              | 2,150,925     | 269,162  | 1,150,247    | 592,183     |
| 25 | 13 | 2031 |              | 1,299,480     | 269,162  | 1,150,247    | 592,183     |
|    |    |      | Sum          | Summary       | Timeline | Debt Serv    | Demand Proj |

However, the starting point for EDU accumulation remains 2014, which I believe to be an unintentional error.



The rate model includes Average Daily Demand (ADD) input for 2018 (15.9 million gallons per day) and a comment for the cell that calculates the denominator (EDUs accumulated) stating “From June 2018.” The formula still computes the accumulation from 2014 through 2035. It looks like the formula should have been edited to “G9-G6” which would result in the MP projecting EDU additions from 2018 through 2035 to be 6,600.

| Year                | 2008 Master Plan Projected ADD (mgd) | 2017 Master Plan Projected ADD (mgd) | 2017 Master Plan Projected Annual Increase (%) | 2014 EDU Demand        | Paid EDUs                               |
|---------------------|--------------------------------------|--------------------------------------|------------------------------------------------|------------------------|-----------------------------------------|
| 2014 <sup>(1)</sup> | --                                   | 14.8                                 | --                                             | 14.8                   | 31,877                                  |
| 2020                | 26.9                                 | 17                                   | 2.34%                                          | 15.9                   | 32,671                                  |
| 2025                | 29.1                                 | 18.6                                 | 1.82%                                          |                        |                                         |
| 2030                | 31.2                                 | 19                                   | 0.43%                                          |                        |                                         |
| 2035                | --                                   | 19.2                                 | 0.21%                                          | 19.2                   | 31,877                                  |
| Ultimate            | 34.1                                 | 33.6                                 | N/A                                            | Increase in Demand MGD | 4.4                                     |
| Required Capacity   |                                      |                                      |                                                | 4.4                    | Michael P. Arthur:<br>From June 2018 #s |
| Conversion to EDUs  |                                      |                                      |                                                | 8,800.0                |                                         |

The same error was made for the calculation of the Sewer Cap Fee. As is, Vallecitos is paying for seventeen years of expenditures with twenty years of EDUs. Likely an unintentional error, but nevertheless needs to be corrected before presenting at the Public Hearing. If not, recovering the revenue shortfall and the deficit will be unsurmountable, effectively leaving the money paid by ratepayers for developer obligations a permanent shift – not just a loan.

Deficit

There are no special provisions in this rate model to timely recover the deficit. It is the same recovery as was done in previous models. But this deficit is different. It was not manifested from the cyclical nature of the developer fund balance. Yes, the developer fund balance positively correlates with building activity (issuance of building permits) and as such should be a significant surplus now. The unnatural slide or decline in the balance, which started in 2013 while building activity accelerated, was policy-driven.

The causes, as I have explained to you before, are from 1) allowing a particular developer to build free of the Sewer Density Impact Fee, 2) deferral of the time to pay Cap Fees, 3) suspension and refunding of the Sewer Density Impact Fee, 4) delay in implementing adequate Cap Fees, and 5) cash financing developer obligations with ratepayer money.

Ratepayers should not have to wait to 2035 to be paid back for something that they shouldn't have paid for in the first place. The deficit needs to be carved out and recovered in five years – before the next Cap Fee study.

Financing Developer Obligations

Vallecitos has accumulated more ratepayer money than any other agency in San Diego County - \$94 million as of April 30, 2019. Setting rates to accumulate money sufficient to maintain reserves as well as pay developer obligations is not in the best interest of the ratepayer. Using ratepayer money to pay developer obligations is not a benefit to the ratepayer. Paying developer obligations is not a cost of service. Issue debt to pay developer obligations as assumed in the Cap Fee rate model instead of using ratepayer money. Vallecitos has plenty of debt capacity.

Rate Transparency and Integrity

The people's business is to be conducted openly. Proposed Cap Fees were downwardly adjusted in a private meeting with developers. Ratepayers, unwilling creditors, are stakeholders, but were excluded from the proceedings of private meetings. The sole objective of Cap Fees should be to recover developer impacts from developers, not "to be competitive." Since 2013, ratepayers have been unnecessarily burdened with paying ratepayer obligations to keep Cap Fees low, and will continue to unless the preceding concerns are adequately addressed at the Public Hearing for Cap Fees.

Rate integrity includes conservative assumptions in forecasting for the rate model. The last measures of conservatism were eliminated in private meetings with developers when assumed interest rates for financing were reduced. Even the corrected number of EDUs is aggressive as shown here.

|       | EDU Additions            |                |                              |         |
|-------|--------------------------|----------------|------------------------------|---------|
|       | Corrected Proposed Rates |                | Recent Actual Annual Average |         |
|       | 17 Years                 | Annual Average | 5-Year                       | 10-Year |
| Water | 6,600                    | 388            | 303                          | 245     |
| Sewer | 6,000                    | 353            | 288                          | 269     |

The following Attachment A includes tables representing the currently proposed Cap Fees, as well as, and Cap Fee calculations that address ratepayer concerns (shown as "Adjusted"). Please present the adjusted tables at the Public Hearing for consideration.

Thank you,

Tom Scaglione

Attachment A

| Proposed Water Capital Facility Fee Determination |               | Adjusted Water Capital Facility Fee Determination |               |              | Total         |
|---------------------------------------------------|---------------|---------------------------------------------------|---------------|--------------|---------------|
| CIP                                               | \$ 24,556,373 | CIP                                               | \$ 24,556,373 | \$ -         | \$ 24,556,373 |
| Financing costs                                   | 25,733,426    | Financing costs                                   | 25,733,426    | -            | 25,733,426    |
| PV discount                                       | (14,665,625)  | PV discount                                       | (14,665,625)  | -            | (14,665,625)  |
| Existing Debt                                     | 29,059,565    | Existing Debt                                     | 29,059,565    | -            | 29,059,565    |
| Capital Expansion Fund Shortfall                  | 9,161,412     | Deficit                                           | -             | 9,161,412    | 9,161,412     |
| Total Revenue Requiremt (PV)                      | \$ 73,845,151 | Total Revenue Requiremt (PV)                      | \$ 64,683,739 | \$ 9,161,412 | \$ 73,845,151 |
| EDUs                                              | 8,800         | EDUs                                              | 6,600         | 4,120        |               |
| Fee                                               | \$ 8,391      | Fee                                               | \$ 9,801      | \$ 2,224     | \$ 12,025     |

| Proposed Sewer Capital Facility Fee Determination |              |                              |                            |                 |
|---------------------------------------------------|--------------|------------------------------|----------------------------|-----------------|
|                                                   | Pipeline     | Treatment/<br>Outfall (P1-4) | Treatment/<br>Outfall (P5) | Total           |
| CIP                                               | \$24,427,296 | \$35,723,126                 | \$53,372,290               | \$113,522,711   |
| Financing costs                                   | 23,122,306   | 35,902,046                   | 58,203,964                 | \$117,228,316   |
| PV discount                                       | (13,845,659) | (22,291,066)                 | (51,764,683)               | \$ (87,901,408) |
| Existing Debt                                     | 3,767,494    | 32,119,470                   | -                          | \$ 35,886,965   |
| Capital Expansion Fund Shortfall                  | 2,366,618    | 4,454,018                    | -                          | \$ 6,820,636    |
| Total Revenue Requiremt (PV)                      | 39,838,055   | 85,907,594                   | 59,811,572                 | 185,557,220     |
| EDUs                                              | 8,400        | 8,400                        | 27,600                     |                 |
| Fee                                               | \$ 4,743     | \$ 10,227                    | \$ 2,167                   | \$ 17,137       |

| Adjusted Sewer Capital Facility Fee Determination |               |                              |                            |              |                |
|---------------------------------------------------|---------------|------------------------------|----------------------------|--------------|----------------|
|                                                   | Pipeline      | Treatment/<br>Outfall (P1-4) | Treatment/<br>Outfall (P5) | Deficit      | Total          |
| CIP                                               | \$ 24,427,296 | \$ 35,723,126                | \$ 53,372,290              | \$ -         | \$ 113,522,711 |
| Financing costs                                   | 23,122,306    | 35,902,046                   | 58,203,964                 | -            | 117,228,316    |
| PV discount                                       | (13,845,659)  | (22,291,066)                 | (51,764,683)               | -            | (87,901,408)   |
| Existing Debt                                     | 3,767,494     | 32,119,470                   | -                          | -            | 35,886,965     |
| Deficit                                           | -             | -                            | -                          | 6,820,636    | 6,820,636      |
| Total Revenue Requiremt (PV)                      | \$ 37,471,437 | \$ 81,453,576                | \$ 59,811,572              | \$ 6,820,636 | \$ 178,736,584 |
| EDUs                                              | 6,000         | 6,000                        | 25,200                     | 4,320        |                |
| Fee                                               | \$ 6,245      | \$ 13,576                    | \$ 2,373                   | \$ 1,579     | \$ 23,773      |

Note: Vallecitos changed the name "Deficit" to "Fund Shortfall" in the Cap Fee Determination and other documentation. Vallecitos has both a Developer Fund Deficit and a Cap Fee Revenue Shortfall. A Deficit is a negative balance in an account or fund at a point in time. A revenue Shortfall is the difference between anticipated revenues and actual revenues over a period of time. Without correcting the EDUs to 6,600 for Water and 6,000 for Sewer, Vallecitos has a revenue shortfall of \$12 million in water, and \$33 million in sewer, which will be paid for by ratepayers if the corrections aren't made.

| Corrected to 2018 Timeline - EDUs to Recover Deficit before Next MP |                 |                  |               |                  |
|---------------------------------------------------------------------|-----------------|------------------|---------------|------------------|
| Year                                                                | ADD in MGD      | Water EDUs Added | AAF in MGD    | Sewer EDUs Added |
| 2018                                                                | 15.9 Actual     |                  | 8.1 Actual    |                  |
| 2019                                                                |                 | 1,100            |               | 1,200            |
| 2020                                                                | 17.0 per MP     | 1,100            | 8.7 per MP    | 1,200            |
| 2021                                                                |                 | 640              |               | 640              |
| 2022                                                                | ADD = Average   | 640              | AAF = Average | 640              |
| 2023                                                                | Daily Water     | 640              | Annual Sewer  | 640              |
| 2024                                                                | Demand          | 640              | Flows         | 640              |
| 2025                                                                | 18.6 per MP     | 640              | 9.5 per MP    | 640              |
| 2026                                                                |                 | 160              |               | 80               |
| 2027                                                                | MGD = Million   | 160              |               | 80               |
| 2028                                                                | Gallons per Day | 160              |               | 80               |
| 2029                                                                |                 | 160              |               | 80               |
| 2030                                                                | 19.0 per MP     | 160              | 9.6 per MP    | 80               |
| 2031                                                                |                 | 80               |               | -                |
| 2032                                                                | MP = Master     | 80               |               | -                |
| 2033                                                                | Plan            | 80               |               | -                |
| 2034                                                                |                 | 80               |               | -                |
| 2035                                                                | 19.2 per MP     | 80               | 9.6 per MP    | -                |
| Total                                                               |                 | 6,600            |               | 6,000            |

| Developer Water Fund Revenue Shortfall |        |          |              |              |              |
|----------------------------------------|--------|----------|--------------|--------------|--------------|
| Year                                   | EDUs   | Proposed | Revenue      |              |              |
| Year                                   | Per MP | Rate     | Cap Study    | Actual       | Shortfall    |
| 2016                                   | 880    | \$ 7,765 | \$ 6,833,200 | \$ 2,247,278 | \$ 4,585,922 |
| 2017                                   | 880    | 8,012    | 7,050,560    | 3,007,411    | 4,043,149    |
| 2018                                   | 880    | 8,337    | 7,336,560    | 3,939,410    | 3,397,150    |
| 2019                                   | 880    | 8,391    |              |              |              |
| Total                                  |        |          | \$21,220,320 | \$ 9,194,099 | \$12,026,221 |

| Developer Sewer Fund Revenue Shortfall |        |          |              |              |              |
|----------------------------------------|--------|----------|--------------|--------------|--------------|
| Year                                   | EDUs   | Proposed | Revenue      |              |              |
| Year                                   | Per MP | Rate     | Cap Study    | Actual       | Shortfall    |
| 2016                                   | 960    | \$15,648 | \$15,022,254 | \$ 3,010,125 | \$12,012,129 |
| 2017                                   | 960    | 15,962   | 15,323,064   | 3,321,625    | 12,001,439   |
| 2018                                   | 960    | 16,590   | 15,926,348   | 6,977,892    | 8,948,456    |
| 2019                                   | 960    | 17,137   |              |              |              |
| Total                                  |        |          | \$46,271,666 | \$13,309,642 | \$32,962,024 |