

**MWD**

METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

March 30, 1993

*To:* Board of Directors (Finance and Insurance Committee--Information)  
 (Water Problems Committee--Information)  
 (Special Committee on Financial Policy--Information)  
*From:* General Manager  
*Subject:* Financial Structure Study Alternatives

A variety of water rate structures and additional revenue sources are being considered in the Financial Structure Study (formerly called the Water Rate Structure Study). These alternatives include traditional methods and other structures tailored for Metropolitan's situation. The additional revenue sources may be used in conjunction with one of the water rate structures to help meet the Financial Structure Study objectives established by the Board. The alternative rate structures and additional revenue sources summarized in this Board letter are preliminary and may be modified.

The following alternative water rate structures are proposed for consideration in the Financial Structure Study:

- Basic/Seasonal Storage Service - The basic/seasonal storage rate concept establishes a base rate and a discounted rate for additional water taken during a non-peak period. Water taken at the discounted rate is stored and used during a peak period or in times of supply shortage. This alternative represents Metropolitan's current rate structure with the seasonal storage discount.
- No Net Gain/Marginal Cost Pricing - A marginal cost rate structure is designed to set rates equal to the cost of providing the next increment of service to the customer. Under this theory, water rates set at the marginal cost should send the most accurate signal to the customer as to what it costs the utility to provide the additional unit of service. Customers can then make the decision as to what they are willing to consume at the given rate. The objective of marginal cost pricing is to promote the most efficient use of the resource by pricing at the marginal cost of production. The Chairman of the

Board's "No Net Gain" concept is a form of marginal cost pricing.

- Winter/Summer - A winter/summer rate structure increases all rates during a utility's peak period, generally May through September.
- Commodity-Demand - In the commodity-demand method, costs of service are separated into three primary cost components:
  - (1) Commodity costs - costs that tend to vary with the quantity of water produced, such as chemicals and power.
  - (2) Demand costs - costs associated with providing facilities to meet the peak rates of use placed on the system by the customers.
  - (3) Customer costs - costs associated with serving customers, irrespective of the amount or rate of water use, such as billing.
- Base-Extra Capacity - In the base-extra capacity method, costs of service are usually separated into three primary cost components:
  - (1) Base costs - capital costs and operation and maintenance (O&M) expenses associated with service to customers under average load conditions, without the elements of cost incurred to meet water use variations and resulting peaks in demand.
  - (2) Extra capacity costs - capital costs and O&M expenses associated with meeting requirements for system capacity beyond that required for average rate of use.
  - (3) Customer costs - costs associated with serving customers, irrespective of the amount or rate of water use.
- Zone of Benefits - This type of rate structure would recover the costs for power and treated water facilities from areas benefiting through a regional facilities charge.

- Preorder/Demand Charge - With this type of rate structure, member agencies would preorder the amount of water they want delivered before the fiscal year begins. A base rate would be charged for all of this preordered water whether taken or not. Any water needed beyond the preorder would be charged a surcharge plus the base rate.

Furthermore, the following additional revenue sources are being analyzed:

- Capacity Charge/Capital Facilities Fee (previously referred to as connection fee) - This fee would be a nondiscriminatory charge to cover the capital cost of a public utility facility. Nondiscriminatory means that the fee does not exceed an amount determined on the basis of the same objective criteria and methodology applicable to comparable nonpublic users, and is not in excess of the proportionate share of the cost of the public utility facilities of benefit to the person or property being charged, based upon the proportionate share of use of those facilities.
- Standby Charge - This charge is currently being collected by Metropolitan. A portion of the standby charge is a flat rate applied to all parcels which benefit from the availability of Metropolitan's water supply on a per acre (or parcel if less than one acre) basis. The other portion is based on historical water purchases of each member agency from Metropolitan.
- Peaking Charge - This charge is based on an agency's peaking in some previous period. This fee would capture increased costs associated with system expansion because of peaking.
- Increased Property Taxes - Property taxes are currently being collected by Metropolitan. Staff is evaluating the potential for property tax increases without any voter approval requirement up to a maximum equal to debt service payments on Metropolitan's general obligation bonds and the portion of State Water Contract payments used to pay debt service on State bonds authorized before adoption of Proposition 13.
- Incremental-Cost Pricing Annexation Fee - With this fee, new customers (as they annex to Metropolitan) would be responsible for their share of the cost of

the last increment of reserve capacity in existing system facilities and/or the increment of planned future additions to meet their needs.

Staff is evaluating the above alternative water rate structures and additional revenue sources with the intention of recommending a shorter listing for Board approval prior to conducting an analysis of each alternate. This short listing will maximize staff's effectiveness and focus on the alternatives that the Board believes have the most promise of meeting the Financial Structure Study objectives previously presented.

Board Committee Assignment

This letter is referred for information to the Water Problems Committee pursuant to its authority to study the selling prices of water under the Administrative Code Section 2481(c) and the Finance and Insurance Committee and Special Committee on Financial Policy pursuant to their authority to study the determination of revenues to be obtained through sales of water under the Administrative Code Section 2441(e).

Recommendation

For information only.

*for*   
for Carl Boronkay

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