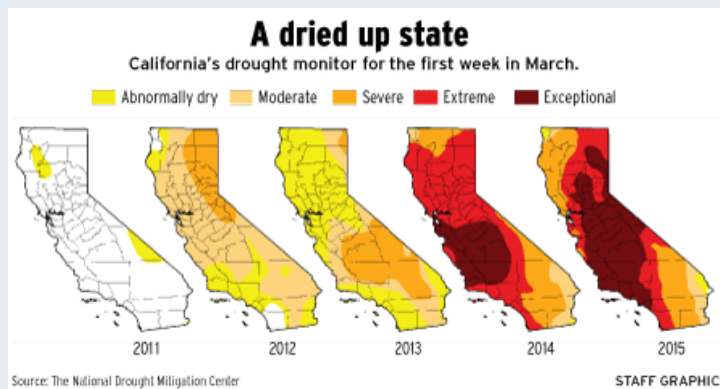


# Fiscal Impacts of the California Drought On Local Public Agencies

Summer 2015

**On Thursday, April 2, 2014, the Governor ordered 25% mandatory cutbacks for water usage across the State. With just 5% of normal snowpack present, many predict that this initial mandatory rationing may just be the start of a much more drastic cutback affecting residents and, increasingly, the State's agriculture and business interests.**



**The BIG QUESTION is: what does this mean for public agencies that provide water as a service?**

## Potential Impacts

Most water (and many wastewater) utilities charge customers in two ways: a fixed or standby charge and a "volumetric" charge based on usage.

For most utilities, volumetric revenue represents more than 70% of total collections. A State-mandated reduction in usage (conservation) is projected to potentially impact revenues by 15% to 20%. In fact, the reduction in volumetric revenue could be greater if the utility has a tiered rate structure encouraging reduced consumption from the highest revenue category. Any reduction in revenues will impact Net Revenues, and therefore, any outstanding bond debt service coverage calculations. A reduced coverage ratio could trigger rate covenants forcing the public agency to raise user rates.

## Recommendation

NHA Advisors recommends that all water utility agencies quantify and analyze the potential financial impact of State-mandated conservation measures on revenues. If bond covenants (debt service coverage) are approaching minimum ratios, the agency must be proactive and start the rate modification process (Prop. 218 public hearing). There are a number of creative approaches to structuring an emergency rate increase in response to the drought. NHA Advisors is actively working with many public agencies to analyze rate covenant compliance, rate structures, and other emergency revenue provisions.

The State Appellate Court decision on the City of San Juan Capistrano's water rates is a significant factor in the structuring of tiered water rates. Recent water rate studies have encouraged the reduction in tiers, which has shown to be the most effective tool for conservation. Any future rate study must quantify the cost of service of providing water in order to create multiple tiered pricing.

The good news from the San Juan Capistrano decision is that the court upheld the right of utilities to fund "purple pipe" projects intended to provide reclaimed water to specific customers through rates levied on the entire utility.

AB 850 provides some additional help on this important issue, enabling a back-charge under Prop. 218 for ratepayers receiving reclaimed water. NHA Advisors is working closely with many of our public agency clients to understand the impact of the recent court case and AB 850 as well as other "on bill" financing options for water conservation projects for ratepayers.

Should you have any question on this topic or our work with public agencies throughout the State that have been impacted by these events, we are ready and willing to share what we have learned.